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S. Hrg. 99-246, Pt. XI

TAX REFORM PROPOSALS—XI

MF 1130 ORIGINAL

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

JULY 9, 1985

(Professional Organizations and Charitable Contributions)

COMPLETED
196

Printed for the use of the Committee on Finance

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TAX REFORM PROPOSALS—XI

TUESDAY, JULY 9, 1985

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m. in room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman) presiding.

Present: Senators Packwood, Durenberger, Symms, Grassley, Bentsen, Matsunaga, and Moynihan.

[The press release announcing the hearing follows:]

[Press Release No. 85-048]

TAX REFORM HEARINGS IN FINANCE COMMITTEE TO CONTINUE IN JULY

Examination of President Ronald Reagan's tax reform proposal will continue in July with a series of hearings before the Senate Committee on Finance, Chairman Bob Packwood (R-Oregon), said today.

"We made a good start on the hearing portion of this long process toward overhaul of the Internal Revenue Code during June," Senator Packwood said. "The hearings we have scheduled for July will take us further toward our goal of having a bill to the President by Christmas."

The hearing announced today by Senator Packwood include:

On Wednesday, July 10, the Committee is to receive testimony from public witnesses on the anticipated impact the tax reform proposal will have on agriculture, timber and small business.

The CHAIRMAN. The hearing will come to order, please. This is one of our continuing series of public hearings on the President's tax reform proposal, and this morning we will hear testimony from witnesses representing professional groups and charitable organizations. These witnesses have been invited here to share with the committee their views of the proposal, and we thank them for their interest and look forward to the information they share with the committee. We will start with a panel of Mr. James Lewis, the chairman of the American Bar Association, section on taxation; Mr. Albert Ellentuck, the chairman of the Federal tax executive committee of the American Institute of Certified Public Accountants; and Mr. David Silverman, co-chairman of the Government relations, National Association of Enrolled Agents. Mr. Lewis, why don't you go first?

STATEMENT OF JAMES B. LEWIS, CHAIRMAN, AMERICAN BAR ASSOCIATION, SECTION OF TAXATION, WASHINGTON, DC

Mr. LEWIS. Thank you, Mr. Chairman. Mr. Chairman and members of the committee——

The CHAIRMAN. Let me interrupt you to say again that, although I think all of the witnesses have been notified, your statements will be in the record in their entirety and we do ask you to hold yourself to the limit that we ask of our witnesses of 5 minutes. Thank you.

Mr. LEWIS. Thank you. I am James B. Lewis, chairman of the section of taxation of the American Bar Association. I appear today to express the views of that association on tax reform. ABA President Shepherd regrets his inability to appear. The ABA has adopted resolutions asking Congress first to simplify the Federal tax laws to the maximum extent consistent with equity, efficiency, and the need for revenue, and second, to provide a broader and more stable tax base with such lower tax rates as that would permit. Creation of a broad tax base has two obvious objectives. The first is to permit rate reduction, but the second and much more important one is to ensure that people with equal economic incomes pay equal taxes. The present tax law falls far short of that goal. Taxpayers who wish to do so are now able to shelter themselves from taxation by investing in widely advertised tax shelters. The escape of their income from tax makes it necessary to keep the tax rates unduly high on those who do not choose to follow this practice. These tax shelters complicate compliance, complicate administration, and are a big drain on the resources of the Internal Revenue Service and the courts. A purely broad tax base would solve these problems. Elimination of these tax preferences would serve the goal of equity and also the goal of simplification. Since 1975, we have had six major tax bills, which have added about 1,800 pages to the Internal Revenue Code with more than 4,000 pages of legislative history. Virtually without exception, these six bills have complicated the income tax, instead of simplifying it. What is needed is a new approach. I cannot today, in speaking for the ABA, address the individual items in the President's tax package, but I can urge you in the strongest possible terms to review this subject to consider the unfairness that tax shelters and preferences cause in the tax system, the adverse effects upon voluntary compliance of that perceived and real unfairness, and the impossibility in our political system to say "yes" to some groups who ask for special preferences and "no" to others. Let me address the lawyer's role in tax reform briefly. Why did the ABA adopt these resolutions calling for a broader tax base? That is a fair question because lawyers are often perceived as profiting from the present complex system. In fact, however, I know from discussions with my brethren at the bar that lawyers, like their clients, deplore the present complexity. A fairer, simpler, more stable tax base is a public need, and the ABA warmly supports that goal. Because of the diversity of their views and their ethical duties to represent their clients effectively, lawyers will divide on almost any individual proposal. In recognition of that fact, the ABA resolutions are very general in their scope and do not speak to specific items. Nevertheless, the ABA strongly supports tax equity, base broadening, simplification, and stability.

This ends my statement for the ABA, but in my individual capacity, I will report on a meeting a month ago of 40 key members of the section of taxation devoted to the President's tax proposals. The great concern expressed at that meeting was that, in the legislative process, this unique opportunity for tax reform will be lost. The fear is that base-broadening provisions will, in response to lobbying pressures, be stripped from the bill, converting it into another of the complex acts that we have seen enacted in recent years. None of the participating ABA members wants to see that happen. Many of them deplore the fact that President Reagan has already taken steps in that direction in his current proposals. In developing a tax bill, your committee should test it for purity against the Treasury Department's November 1984 proposals. That is the model that you should follow, and we realize that will require your committee to say "no" to those who ask for special exceptions. Thank you for inviting me to speak on this important subject.

[The prepared written statement of Mr. Lewis follows:]

STATEMENT OF

JAMES B. LEWIS
CHAIRMAN
SECTION OF TAXATION

of the

AMERICAN BAR ASSOCIATION

before the

COMMITTEE ON FINANCE

of the

UNITED STATES SENATE

on

PRESIDENT REAGAN'S PROPOSALS FOR COMPREHENSIVE TAX REFORM

July 9, 1985

STATEMENT OF
JAMES B. LEWIS, CHAIRMAN,
SECTION OF TAXATION
# of the AMERICAN BAR ASSOCIATION,
before the COMMITTEE ON FINANCE,
UNITED STATES SENATE
on PRESIDENT REAGAN'S PROPOSALS
FOR COMPREHENSIVE TAX REFORM

July 9, 1985

I am James B. Lewis, Chairman of the Section of Taxation of the American Bar Association. I appear today to express the views of the American Bar Association on tax reform. Those views are embodied in resolutions adopted by the Association in February 1985 (the "ABA resolutions"). A copy of those resolutions and the accompanying report is annexed.

The ABA resolutions asked Congress, first, to simplify the federal tax laws to the maximum extent consistent with basic equity, efficiency, and the need for revenue, and, second, to provide a more comprehensive and stable tax base, with such lower rates as would be permitted by the expanded base.

The three key words in the ABA resolutions are "comprehensive," "simplify," and "stable," which I shall discuss in turn.

Comprehensiveness

Creation of a comprehensive tax base has two obvious objectives. The first, but less important, objective is to permit rate reduction. The second, but more important, objective is to promote horizontal equity, i.e., to require taxpayers with equal amounts of income to pay equal taxes.

The present Internal Revenue Code falls far short of that goal. The unfairness has created increasing disrespect for the system and, undoubtedly, has encouraged tax cheating, which has reached alarming proportions. Clearly, improved equity is necessary to reverse those disturbing trends.

Taxpayers with significant monetary resources are able, under present law, to escape or minimize tax liabilities by exploiting tax preferences. The escape of their income from the tax base has made it necessary to keep tax rates at high levels. Those who do not engage in tax sheltering are overtaxed. Tax shelter investments are complicating tax administration and compliance and are straining the resources of the Internal Revenue Service and the courts. A comprehensive tax base would alleviate those problems.

Simplification

The holes in the tax base have been created to promote economic or social objectives, most of which, examined in isolation, are laudable. In every case, those special exemptions, exclusions, deductions, and credits have complicated the law, lengthened the tax return, and forced taxpayers to seek professional assistance. Elimination of the tax preferences would serve not only the goal of equity, but also the goal of simplification.

Everyone talks about tax simplification, but no one has done anything about it. Since 1975 six major tax bills have been enacted, adding 1,800 pages of new legislation and more than 4,000 pages of accompanying legislative history. Virtually without exception, those bills have complicated the law instead of simplifying it. What is needed is a new approach.

Stability

A third possible advantage that might flow from creation of a comprehensive tax base with lower rates and elimination of special tax concessions is greater stability. Undoubtedly, the enactment of special provisions for one taxpayer group encourages pleas for special provisions for others. Congressional dedication to a comprehensive tax base should make it easier to resist such pressures. If a tax reform bill can be devised that meets the objectives of fairness and simplicity, its enactment could and should be followed by a tax legislative moratorium.

Development of position papers

In the hope of developing a tax reform bill that will achieve the above three goals -- fairness, simplification, and stability -- the ABA Section of Taxation has asked its members to prepare position papers on each important current proposal. A substantial number of those papers have been reviewed and submitted to the Treasury and to the Congressional tax staffs, and others are under preparation. Those papers do not represent ABA or Section of Taxation positions. We have encouraged other ABA Sections that are affected by the current tax reform proposals to ask their members to prepare and submit similar papers.

Tax shelters

Tax savings obtained through tax shelters are not entirely a windfall because the returns from such investments may reflect the tax benefit to some degree. Thus, for example, the yields on tax-exempt bonds are less than those on taxable bonds. The tax benefit thereby flows through to some extent to achieve the economic or social objective underlying the tax preference which is the basis of the tax shelter. But, clearly, all of the benefit does not flow through, the tax shelter investors thereby achieve an undue tax benefit, and a middleman captures some of the benefit. A comprehensive tax base would rely on the market rather than the tax system to allocate capital, and tax preferences are often not the best means of promoting social or economic policies.

The major departures from a comprehensive tax base, which result in loss of horizontal equity and many of which are the basis of tax shelters, were addressed in the November 1984 Treasury Department proposals. Many of these problems have been treated differently in the President's tax proposals, and in the other major tax reform plans before you, such as the Bradley-Gephardt and Kemp-Kasten bills. It is not my role here today in speaking for the American Bar Association to address the proper tax treatment of specific items; rather, I can only urge in the strongest possible terms that, in assessing these matters, you consider the unfairness that tax preferences inherently cause in the tax system, the adverse effects upon voluntary compliance that this unfairness promotes, and the impossibility in our political system of granting preferences to some groups or for some purposes and denying them to others.

An illustration - the capital gain preference

Let me address only one major illustration. One of the largest sources of lack of horizontal equity, complexity, and instability in our tax system is the capital gain preference. It is a major foundation for many tax shelters. The greatest single justification for special taxation of capital gains has been to compensate for inflation, which otherwise results in over-taxation. The Treasury's November 1984 proposal for elimination of the capital gain preference addressed that problem directly by adjusting the cost basis of assets for inflation. Other tax reform plans now before you address that problem in quite different ways. Some argue that a preferential capital gain tax rate is necessary to induce risk-taking investments. There are, however, other options more consistent with a comprehensive tax base which may address the risk factor, such as the treatment of losses. I urge you to consider all of the alternatives while seeking to achieve, as far as possible, a comprehensive tax base.

The lawyer's role in tax reform

Why did the ABA adopt these important resolutions and why has the Section of Taxation devoted its resources to their support? That is a fair question because lawyers are often said to be among the chief beneficiaries of the present complex tax system. The fact is that most lawyers share their clients' dissatisfaction with the present incomprehensible law. Moreover, lawyers have imposed upon themselves ethical rules that require them to work for improvement in the legal system. A fairer, simpler, more stable tax structure is a public need, and the American Bar Association warmly supports that goal.

Because of the diversity of their views and their ethical duties to represent their clients effectively, lawyers will divide on almost any specific tax reform proposal. In recognition of that fact, the ABA resolutions declined to support any specific proposal or set of proposals. Nevertheless, the ABA strongly supports the principles of base broadening, fairness in distribution of the tax burden, simplification, and stability. We urge your Committee to proceed accordingly. Your goal should be optimal base broadening, and that will require you to say no to those who ask for special exceptions.

A private observation

This ends my statement for the ABA. In my individual capacity, however, I will report on a meeting a month ago of 40 key members of the ABA Section of Taxation, devoted to the President's tax proposals. The great concern expressed was that, in the legislative process, this unique opportunity for tax reform will be lost. The fear is that base-broadening provisions will, in response to lobbying pressures, be stripped from the bill, converting it into another of the complicating revenue acts that have marred the Internal Revenue Code in recent years. None of the participating ABA members want to see that happen. Many of them deplore the fact that the President has already taken a step in that direction.

As you develop the forthcoming tax bill, you should test it for purity against the Treasury Department's November 1984 proposals. This is not to say that every one of those proposals was well conceived. Many of them can be improved, and a few--a very few-- should be abandoned. But, taken as a whole, the Treasury's November 1984 proposals are the model you should seek to achieve.

Thank you for inviting me to testify on this important matter.

AMERICAN BAR ASSOCIATION

SECTION OF TAXATION

REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED that the American Bar Association recommends to the Congress that it (1) simplify the federal tax laws to the maximum extent consistent with basic equity, efficiency and the need for revenue, so that such laws can be easily understood and complied with by taxpayers and fairly and consistently administered and enforced by the Treasury Department, and (2) revise such laws to provide for more comprehensive and stable bases, with such lower rates as would be permitted by the expanded bases.

FURTHER RESOLVED that the above resolution should not be construed as supporting any particular set of proposals.

FURTHER RESOLVED that the President of the Association, the Section of Taxation, and other Sections of the Association designated by the President, are authorized to work with the Congress and the Administration to achieve such goals.

Most troublesome is the growth in underreporting of actual tax liability. Underreporting has increased at a disturbing rate, to approximately the $100 billion level. Noncompliance is of such magnitude that the Association has established, and is seeking substantial funding for, a Commission on Taxpayer Compliance.

These developments have compounded the unfairness of the income tax and seriously undermined taxpayer morale. Our tax system is designed to function on the basis of voluntary compliance, and it cannot do that if taxpayers become disaffected.

Another point made by economists is as follows: The tax preferences encourage unproductive investment and produce economic distortions. The choice of investment should be dictated by market rather than tax considerations. A more neutral tax system should result in a better allocation of economic resources.

Congress has reacted to the burgeoning of tax preferences and tax noncompliance by creating an additional level of statutory complexity, in the form of new penalties and other anti-avoidance provisions. These innovations make it difficult for even the tax expert to keep abreast of the recent tax legislative packages. The effectiveness of these innovations is still largely untested and, in the minds of many, doubtful.

The potential solution

These are problems that can best be solved by creating a simpler and more comprehensive income tax base and by reducing tax rates accordingly. The broadened base would narrow the opportunity for tax shelters and the lowered rates would reduce the demand for them.

Understandably, there is increasing interest in tax reform of this kind. The Bradley-Gephardt, Kemp-Kasten, and similar bills pending in the Ninety-Eighth Congress were aimed at that goal. In November, 1984, President Reagan received from the Treasury Department a comprehensive report on tax reform. In his State of the Union address to Congress on February 6, 1985, President Reagan said: "The Treasury Department has produced an excellent reform plan whose principles will guide the final proposal that we will ask you to enact."

The Treasury proposal

The Treasury proposed a substantially more comprehensive income tax base and significantly lower rates. The current 17-bracket individual rate schedule, ranging from 11 to 50 percent, would be replaced by three rate brackets of 15, 25, and 35 percent. The current five-bracket corporate rate schedule, ranging from 15 to 46 percent, would be replaced by a 33 percent flat rate. The proposal would greatly simplify the income tax and sharply reduce inequities.

The Treasury proposal is structured so as to produce approximately the same revenue as the present income tax, and so as not to affect significantly the distribution of the burden of the tax among classes of individual taxpayers by income level. The proposal would redistribute the tax burden significantly only by increasing the taxes of those who now receive tax preferences and reducing the taxes of those who do not. By providing a neutral capital cost recovery system, the proposal would eliminate the tax advantages now enjoyed by capital-intensive corporations, and would shift a portion of the tax burden from individuals to corporations.

Among the significant areas on which the Treasury proposal would not substantially intrude are the home mortgage interest deduction, the deductions for medical expenses and casualty losses, most aspects of the private retirement system, the exemption of interest on state and local general obligations, the tax treatment of income and activities of exempt organizations (charities, pension trusts, etc.), and the exemption of the poor. The Treasury proposal would preserve the mortgage interest deduction for the principal residence, expand the deduction for individual retirement accounts (IRAs) but repeal preferred treatment for cash or deferred (section 401(k)) plans, tax interest on future issues of state and local private purpose obligations, and increase tax relief at the poverty level. The Treasury proposal would preserve indexation of the income tax rates and exemptions to eliminate the adverse impact of inflation, and would extend the indexing principle to other areas, including indexation of the basis of investments.

Outside the above areas, the Treasury proposal would establish a substantially more comprehensive income tax base, one closely approaching economic income.

Reactions

The reaction of the business community and the press to the Treasury proposal has been, on the whole, constructive. The complaints of those whose tax preferences are threatened have been tempered by the realization that a comprehensive income tax base is attainable only by elimination of preferences generally. That realization has tended to mute--although it has by no means eliminated--the complaints (to cite examples) of New York State and City officials about the proposed elimination of the deduction for state and local taxes, of university officials about the proposed cutback on the charitable deduction for contributions of appreciated property, and of business associations about the proposals for slower capital cost recovery and for elimination of capital gain preferences.

Several Congressional leaders have observed that attack on the budget deficit should take priority over the Treasury proposal for income tax base broadening and rate reduction. They have indicated reluctance to consider early enactment of the Treasury proposal because it does not address the budget deficit issue. Some members of the public have reacted warily to the Treasury proposal out of concern that its enactment might be accompanied or followed by a substantial rate increase to reduce the budget gap. Others have responded that a tax increase would only strengthen the case for the equity objectives of the Treasury proposal.

The recommendation

We are submitting the recommendation in brief and general form for several reasons:

First, the recommendation is being submitted in a time of fluidity and of national debate over tax policy. The extent to which the Administration's final proposal will differ from the Treasury report is unpredictable. The focus of attention will immediately shift to the final proposal. The Association cannot act with specificity to a situation so fluid.

Second, it does not seem feasible to delay action on this matter. House Ways and Means Committee hearings are scheduled to begin on February 27, prior to receipt of the Administration's final proposal. Unless the Association is prepared to participate, the opportunity will be lost.

Third, it would not be feasible for the Association to attempt to compile a comprehensive list of "good" tax preferences and a list of "bad" ones. Agreement would be difficult because, individually, a case can be made for each of the preferences. The mice would eat the resolutions.

Nevertheless, we submit, it should be possible to develop a consensus for the general principles of base broadening and simplification. That can be done only in general terms. Association testimony can then reflect application of general principles to specific proposals under consideration.

To permit the Association to react flexibly, this report and the accompanying recommendation should not be construed as supporting any particular set of proposals. By not tying the recommendation to the Treasury report, we eliminate any current pressure for reconsideration by the Association of its current tax legislative positions, such as its position favoring permanent enactment of the prepaid legal services plan provision and its position on revision of the generation-skipping transfer tax.

The accompanying recommendation, like the Association's 1976 simplification recommendation, is not confined to the income tax. If other options, such as a consumption tax, are advanced, the recommendation is broad enough to authorize the Association to respond.

Additional flexibility and safeguards are provided by the proposed second resolution, which would direct the Association's President to take the leading role in implementing the recommendation. If the resolutions are approved, the Section of Taxation would look forward to working with the President and with other Sections designated by him.

The challenge to the organized bar

The American Bar Association will face a significant challenge when President Reagan sends Congress the final proposal. It would seem difficult for the Association to remain silent on, or to resist totally, a proposed reform of such substantial proportions. Yet, support of the principle of such reform would inevitably threaten (to cite another example) the qualified group legal service plan exclusion, support of which exclusion is an Association policy. Abstention or opposition to base broadening and simplification by the organized bar would surely, and not inappropriately, attract the charge that the bar is merely protecting its own turf. Indeed, lawyers are often accused of being one of the sources of the present complexity and unfairness of the system.

Lawyers have no particular expertness, as a profession, in matters relating to the budget or how the deficit can best be reduced. For that reason, the accompanying recommendation does not address those issues. Tax base restructuring and simplification, however, is a process in which lawyers, by reason of their training and practical experience, can make a substantial contribution.

The Association can and should render technical assistance on this subject through its Section of Taxation. The Officers of the Section of Taxation have assigned to one or more substantive committees of the Section responsibility for technical review of each of the many legislative proposals contained in the Treasury report. Interesting technical issues (to mention only a few) are posed in the implementation of the Treasury proposals for indexation in new areas, for limiting the interest expense deduction, for dividend relief, and for capital loss limitation, as well as in the general areas of transition and grandfathering.

On the policy level, the Association, by adopting the recommendation, can place its prestige behind the effort for tax restructuring and simplification. This subject is of crucial importance at this time because public interest has been focused as never before on the structure of our tax laws. The Association should not reject the challenge that now faces it.

Conclusion

For all of the above reasons, the recommendation should be adopted as Association policy.

James B. Lewis
Chairman

The CHAIRMAN. Thank you. Mr. Ellentuck.

STATEMENT OF ALBERT B. ELLENTUCK, CHAIRMAN, TAX DIVISION, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, WASHINGTON, DC

Mr. ELLENTUCK. Thank you, Mr. Chairman. I am Albert Ellentuck, and I am here as chairman of the tax division of the American Institute of Certified Public Accountants. The AICPA is the national organization of CPA's, with over 235,000 members. Many of our members not only work daily with the Internal Revenue Code in representing taxpayers but also observe the reaction of those taxpayers to our tax system. As Commissioner Eggar pointed out to you in his recent testimony, there have been 19 major tax law changes in the last 22 years. Today the code must be printed in two volumes, the regulations in four. It is no wonder that there is growing difficulty on the part of the average tax practitioner in coping with the tax laws. Accordingly, we urge you to give high priority to tax simplification in working with these proposals. Providing incentives, closing loopholes, achieving reforms and other laudible goals come at a steep price in terms of complexity. Some would argue that practitioners reap the benefits of additional complexity, but it is not the kind of benefit we seek or the kind of benefit we want. No tax practitioner wants to see the effectiveness of our self assessment system collapse under its own weight. We want to work together with Congress to simplify the system. The AICPA had previously suggested a moratorium on tax legislation while a comprehensive plan for basic improvements in our tax laws was developed. We also testified before this committee in that regard on prior occasions, and we have also suggested a national commission on tax simplification, such as Congress used in effectively dealing with the problems of Social Security. Initially, as we see it—in terms of simplicity—the President's proposals do seem to be an overall improvement over those issued by Treasury last November. However, there are still many areas of complexity in the May 29 proposals. As examples of added complexity, we point out the revised alternative minimum tax, new depreciation rules, basis indexation, recapture of prior ACRS cost recovery, investment interest limitation, the mandatory use of the per-country limit for foreign tax credits, and the requirement for many taxpayers to change to the accrual method of accounting. This latter proposal in particular is one that we believe is neither simple nor fair. It would require many thousands of taxpayers who are owners of service organizations to pay tax on income before they receive it if the business has more than $5 million of average gross receipts or if it regularly uses a method other than cash for reporting income or losses to owners or creditors. It would cover a wide range of service businesses, including advertising agencies, architects, consulting firms, lawyers, accountants, and personnel agencies. If a change to the accrual method is required, those taxpayers would have to learn a new method of accounting, install a new system of controls, and change partnership agreements. The level of complexity would therefore be significantly increased, and the transition to and maintenance of the accrual method would also be very difficult and expensive for many taxpayers. In contrast, individual and small business taxpayers understand the cash method of accounting—the method they use for their tax returns, their checkbooks, and their wallets. With the cash method, you have income when it is received, and you have an expense or deduction when you pay for it. The method is simple and definite and based on the ability to pay. It has been a fundamental part of our tax system as it relates to individuals and often to personal service businesses for as long as we have had income taxes. Most personal service businesses, particularly partnerships, have been using the cash basis for tax for so long that imposing an accrual method opens a variety of interpretative problems which would take the IRS and practitioners years to resolve. We urge you to reject this proposal because it works against the objectives of simplification and equity. It raises a multitude of problems not addressed in the proposal, far beyond its purported limited scope. It is also unfair to tax most individual taxpayers on the basis of income only when it is received while taxing self-employed professionals and other personal service providers on income before it is received. We believe that the costs and difficulties of implementing this change would far exceed any revenue benefits to Treasury. Thank you. That is the extent of my remarks, and we would be happy to answer questions.

[The prepared written statement of Mr. Ellentuck follows:]

TESTIMONY OF

ALBERT B. ELLENTUCK

CHAIRMAN OF THE TAX DIVISION
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

BEFORE THE

SENATE COMMITTEE ON FINANCE

REGARDING

THE PRESIDENT'S TAX PROPOSALS FOR FAIRNESS
GROWTH AND SIMPLICITY

July 9, 1985

Good morning. I am Albert B. Ellentuck, and I am here in my capacity as Chairman of the Tax Division of the American Institute of Certified Public Accountants. The AICPA is the national organization of certified public accountants with over 235,000 members. Many of our members not only work daily with the Internal Revenue Code in representing taxpayers but also observe the reaction of those taxpayers, both large and small, to the tax system.

In observing the effects of the tax system and in trying to interpret its many interrelated provisions, we are deeply concerned with the present level of its complexity.

Even some of the most sophisticated taxpayers and practitioners are becoming overwhelmed by the rapidity and vagueness of tax law changes. As Commissioner Egger pointed out to you in his recent testimony, there have been 19 major tax law changes in the last 22 years. Today, the Internal Revenue Code must be printed in two volumes. Regulations to implement these provisions have been seriously delayed. Current backlogs of taxpayer inquiries and docketed court cases are a further symptom of the complexities. It is of little wonder then that there is a growing difficulty on the part of the average tax practitioner to cope with the tax laws.

Accordingly, we urge you to give a high priority to tax simplification in working towards the various objectives of these proposals. Providing incentives, closing loopholes, raising revenue, achieving reforms, and other laudable goals come at a steep price in terms of complexity. Some would argue that practitioners reap the benefits of additional complexity through additional business, but it is not the kind of benefit we seek or want. No tax practitioner wants to see the effectiveness of our self-assessment tax system collapse under its own weight. We want to work together with Congress to simplify the system.

The AICPA has for many years attempted to help in simplification efforts with regard to various tax provisions, as well as in major areas of the tax law, such as Subchapter S, installment sales, and domestic relations.

As you know, change--in and of itself--is a major source of complexity, and the continuing series of major annual tax bills, further complicates the income tax. This change undermines the taxpayer confidence required for long-range commitments of the capital necessary for true economic growth.

We are concerned that the proposals now before you are but one more step in the never ending road of tax law changes in which simplification becomes less and less possible to achieve.

The AICPA has previously suggested a moratorium on tax legislation to put a halt to the complexity of change while a comprehensive plan for basic improvements in our tax law is developed. We have so testified before this committee on prior occasions. We have also suggested a national commission on tax simplification, such as Congress used in effectively dealing with the problems of social security. The comprehensive and often controversial nature of the proposals now before you attempt to achieve various goals which are many times mutually exclusive. This difficulty indicates that what may be needed is more study and some further independent evaluations of the economic impact.

Initially, it seems clear that, while still complex, the President's proposals are an overall improvement in simplification, from those issued last November by the Treasury Department. However, there are still many areas with complexity problems in the May 29th proposals. We would point out the revised alternative minimum tax, new depreciation rules, basis indexation, recapture of prior ACRS cost recovery, the investment interest limitation, the mandatory use of the per-country limit for foreign tax credits, and the requirement for many taxpayers to change to the accrual method of accounting as examples of added complexity.

The AICPA tax division is currently reviewing the entire Administration proposal to develop general and technical comments to aid you and your staffs in the discussions. I expect that our specific comments will focus attention on certain problems with the proposals as well as their implementation and administration. These comments will include a consideration of how the specific proposals will affect simplification, to help us all better understand the cost of these changes in relation to complexity. As soon as we can finalize these comments, we will submit them to you and will be glad to discuss them with your staffs.

We believe that the President's tax proposals and the momentum which has developed for tax simplification offer a real opportunity for improvement. We strongly support efforts to seek simplification and urge you to make this legislation more than just another in the continuing series of major tax law changes. We do understand that there can be trade-offs between simplicity and fairness. There is one issue, however, that we feel is neither fair nor simple, and I would particularly like to bring that to your attention at this point.

Chapter 8.03 of the President's proposals would require thousands of taxpayers who are owners of service organizations to pay tax on income before they receive it, if the business has more than $5 million of annual gross receipts or if it regularly uses a method other than cash of reporting income or losses to owners or creditors. By requiring a change to the accrual method, those taxpayers would have to learn a new method of accounting, install a new system of accounting and controls, and change partnership agreements. It would therefore significantly increase the level of complexity for those who presently use the cash method. While we, as professional accountants, would be called upon to effectuate this change and enhance our business, the transition to and maintenance of the accrual method would be difficult and expensive for many taxpayers.

In contrast, individual and small business taxpayers understand the cash method of accounting. It is the method of accounting they use for their tax returns, their checkbooks, and their wallets. With the cash method, you have income when it is received and you have an expense or deduction when you pay for it. The method is simple and definite and based on ability to pay the tax. It has been a fundamental part of our tax system as it relates to individuals and often to personal service businesses for as long as we have had income taxes.

A great many CPAs practice individually or in partnership groups. The great majority of those CPAs use the cash method, and the resulting income tax basis of accounting. Our members strongly believe that they and other personal service organizations should continue to report on that basis. It is uniquely unfair to tax certain individuals on income which has not yet been received from the client or customer.

Professionals--such as accountants, attorneys, and engineers--practicing alone or in partnership with other individuals do not receive their income in the same manner as corporate executives or employees of other entities. They receive their income when their clients and customers pay them, not when their employer pays them. This proposal would force partners onto an accrual method, regardless of their individual share of partnership gross income.

In our society, fees for professional service are generally not paid in the same month the services are performed. In fact, in many professions, there are often gaps between the time the work is performed, the time when that work is actually billed and the time when that bill is finally collected. And often the amount of such service income is not readily determinable until it is agreed to and collected from the client or customer, often several months later. Therefore, it would be unfair to tax individuals on service income before it is received.

From the standpoint of sound accounting practice, this proposal should not be portrayed as pitting a system conforming to generally accepted accounting principles, that is the accrual method, against one that does not. The use of the accrual method for financial reporting purposes does conform to generally accepted accounting principles. But, the logic of this requirement is obvious: to obtain a full picture of the financial condition of companies--particularly those publicly traded--it is necessary to take into account annual changes to assets, liabilities, equity and funds.

This does not, however, preclude the use of other systems--including the cash basis method--in situations in which it is more appropriate; including income tax reporting. In fact, the Internal Revenue Code requires that accrual basis taxpayers modify their statements, to some degree, using certain cash principles, when reporting for tax purposes. The difficulties of attempting to impose accrual principles on personal service businesses arises from the fact that a whole new set of modifications in application are introduced. Most personal service businesses, particularly partnerships, have been using the cash basis for tax for such a length of time that imposing an accrual method opens a variety of interpretative problems which will take the IRS and tax practitioners years to resolve.

If the accrual method change is adopted, most partnership agreements would have to be renegotiated and revised. In addition to the significant time and expense of such an undertaking, the process would disrupt business activity and complicate business relationships among partners.

Tax proposals often require a trade-off between simplicity and equity, but this proposal manages to work against both tax policy objectives. Under the President's proposal, income would be taxed to certain individuals before they receive it. The resulting cash flow problem could force them to borrow or sell assets to pay their taxes.

We urge you to reject this proposal because it works against the objectives of tax simplification and equity. The proposal raises a multitude of problems, which are not addressed, far beyond its purported limited scope. It is also unfair to tax most individual taxpayers on the basis of income only when it is received while taxing self-employed professionals and other personal service providers on income before it is received. We believe that the cost and difficulties of implementing this change will far exceed any revenue benefit to the Treasury.

I would be happy to answer any questions you may have.

The **Chairman**. Thank you. Mr. Silverman.

STATEMENT OF DAVID J. SILVERMAN, COCHAIRMAN, GOVERNMENT RELATIONS COMMITTEE, NATIONAL ASSOCIATION OF ENROLLED AGENTS, BETHESDA, MD

Mr. **Silverman**. Thank you, Mr. Chairman. My name is David J. Silverman. I am cochairman of the government relations committee of the National Association of Enrolled Agents, whose members are tax practitioners, enrolled to practice before the Internal Revenue Service. And I deeply appreciate this opportunity to be able to share my views with you on the President's proposal to provide for fairness, economic growth, and simplicity in our tax law. The underlying reason that motivated the President to present these proposals is the widely held view that our tax laws and current tax system unfairly favors the rich. If the public indeed perceives that our current tax system is unfair and that the wealthy consistently beat the system, what on earth will Americans think of a new and revised tax system with the marginal rates of taxpayers with income in excess of $200,000 will decrease while the average taxpayer will continue to pay about the same amount of taxes as they did under the old system? Under the President's proposal, an individual with $600,000 of unsheltered income would see his income tax decrease by over $53,000, and I don't believe that the average American taxpayer's criteria for fairness would be met by such an end result. In the era of the two-income family, the elimination of the two wage-earner deduction, taxing the buildup on the life insurance policy, together with taxing the first $300 of employer-provided health insurance benefits would further increase the tax burden of middle income families. While the tax filing process will be simplified under the President's proposal, for those taxpayers who have only income from wages and who do not itemize their deductions, it will be made extremely more complex for those taxpayers who do not fall into that narrow range of income. The capital gain election, reducing the investment interest exemption, together with the new definition of investment interest, indexing depreciation, modification of the alternative minimum tax, and allowing miscellaneous itemized deductions in excess of 1 percent of the adjusted gross income—which I might add requires some understanding of algebra—will dramatically increase complexity. I think the marketplace has already cast its ballot on the issue of simplicity by pushing the stock of H&R Block to a new 52-week high immediately following the President's address to the Nation on May 28. From the conflicting testimony of the economists that have already testified before me, one can only determine that the jury is still out on whether Treasury II will provide for economic growth. Notwithstanding these comments, Mr. Chairman, I support the President's proposal, provided that one important condition is met—that the Congress and the administration provide some type of insurance that they will end what has become the yearly revision of our tax laws. Fairness and simplicity requires continuity, and in order for taxpayers to be treated fairly, they have to have some assurance that the income generated from an investment that they make today will be taxed in future years as it was when they originally made the investment. These annual changes in our tax laws have become a monumental burden to the taxpayers and the Government. A month ago, the Internal Revenue Service announced that 1½ million taxpayers will have to file duplicate tax returns in order to secure their refunds. Congress' ever increasing stream of legislation has caused the IRS to allocate resources away from the processing of tax returns and into the promulgation of rather complex regulations. Each year, millions of hours are spent by both taxpayers and the Government just understanding how income is currently taxed that year. Mr. Chairman, I plan to limit my comments this morning to three topics: the State deduction—the deduction for State and local taxes, the new collection charge for the late payment of taxes. and the recordkeeping and compliance burdens that the proposal will place on small businesses. If it is true that things usually have to get worse before they can get better, I believe that the repeal of the deduction for State and local taxes will end the complacency of taxpayers and high——

The CHAIRMAN. We have to hold our witnesses to 5 minutes, and you have just run out of time. Can you summarize?

Mr. SILVERMAN. Yes; basically, I want to say that we support the provision for the elimination of the State and local taxes. And I believe that the collection charts that the Government is trying to impose will place a burden on the taxpayers. And I believe that some sort of provision should be provided for small business to exempt them from the separately tracking of the $25 meal cap—maybe a $2,000 exemption from that. And I believe that businesses with fewer than 10 employees should also be exempt from including in the income the first $300 of medical insurance benefits. I believe that is a burden that business can no longer continue to maintain. And I thank you, Mr. Chairman.

[The prepared written statement of Mr. Silverman follows:]

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STATEMENT

BY

DAVID J. SILVERMAN

CO-CHAIRMAN, GOVERNMENT RELATIONS COMMITTEE

NATIONAL ASSOCIATION OF ENROLLED AGENTS

ON

THE PRESIDENT'S TAX PROPOSAL

TO THE CONGRESS FOR

FAIRNESS, GROWTH, AND SIMPLICITY

MADE BEFORE THE SENATE FINANCE COMMITTEE

JULY 9, 1985

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NAEA Members Enrolled to Represent Taxpayers Before the Internal Revenue Service

Good Morning, Mr. Chairman,

My name is David J. Silverman. I am Co-Chairman of the Government Relations Committee of The National Association of Enrolled Agents whose members you of course know as tax practitioners enrolled to practice before the Internal Revenue Service.

I deeply appreciate this opportunity to be able to share my views with you on the President's proposal to provide for Fairness, Economic Growth, and Simplicity in our tax laws. An underlying reason behind the President's proposal is the widely held view that the public thinks our present tax system unfairly favors the rich.

If the public indeed perceives our current tax system as unfair and that the wealthy consistently beat the system, what on earth will Americans think of a new and revised tax system where the marginal rates of taxpayers with incomes in excess of $200,000 will decrease by 13% while average taxpayers continue to pay about the same amount of tax as they did under the old system. Under the President's proposal, an individual with $600,000 of unsheltered income would see his income tax decreased by $53,267 (Example 6, Treasury I). I do not believe that the average American taxpayers' criteria for fairness would be met by changes with such an end result.

In the era of the two income family, the elimination of the two wage earner deduction will amount to a tax increase for most middle class families. Taxing the inside buildup of the interest earned on life insurance policies and the first $300 of employer provided health care benefits will further increase the tax burden of middle income families.

While the tax filing process will be simplified under the President's proposal for those taxpayers who only have income from wages and who do not itemize their deductions, it will be made more complex for those taxpayers who do not fall into that narrow range of income.

The capital gain election, reducing the investment interest exemption together with the new definition of investment interest, indexing depreciation, modification of the alternative minimum tax and allowing miscellaneous itemized deductions in excess of 1% of adjusted gross income (which requires some understanding of algebra), will dramatically increase complexity.

The market place has already cast its ballot on the issue of simplicity by pushing the stock of H & R Block to a new 52-week high.

From the conflicting testimony of the economists that have already testified before the Committee, one can only determine that at best the jury is still out on whether Treasury II will provide for economic growth.

Not withstanding my previous comments, Mr. Chairman, I support the President's proposals providing that one very important condition is met -- that Congress and the Administration provide some assurance that they will end what has become the yearly revision of our tax laws. Fairness and simplicity requires continuity. In order for taxpayers to be treated fairly, they have to have some assurance that the income generated from today's investments will be taxed in the same manner in future years, as it was in the year the investment was made. These annual changes in our tax laws have become a burden of monumental proportion to both taxpayers and the government. Four weeks ago, the Internal Revenue Service announced that a million and a half taxpayers will have to file duplicate tax returns in order to secure their refunds. Our Country's ever increasing stream of tax legislation has caused the IRS to allocate resources away from the processing of tax returns and into the promulgation of complex regulations. I am of the belief that tax compliance is being eroded by these constant changes. Each year millions of hours are spent by both IRS employees and the public in order to understand how income is currently being taxed.

Mr. Chairman, I plan to limit my comments this morning to three aspects of the President's proposal -- the deduction for state and local taxes, the new collection charge for the late payment of taxes and the record keeping and compliance burden that the proposal will place on small businesses.

If it's true that things usually have to get worse before they can get better, I believe that the repeal of the deduction for state and local taxes will end the complacency of taxpayers in states with high tax rates, such as New York, where I live. Many people feel, as I do, that the elimination of this deduction will lead to the reduction of taxes in states with high tax rates.

New York's Governor Mario Cuomo objects to the elimination of the deduction for state and local taxes because he feels it is unfair to tax a tax. I also believe it is unfair to tax a tax. However, the validity of Governor Cuomo's argument requires that New York State allow taxpayers to deduct their federal tax when computing their New York State tax liability. New York State does not allow such a deduction. Governor Cuomo's argument, I believe, flunks the test of consistency.

The second item that I would like to comment on deals with my concern about Chapter 4.06 of the President's proposal which would eliminate the present penalty for the late payment of taxes by replacing it with a cost of collection charge. The President's proposal states that this charge is necessary because, and I quote, "current law does not permit the charging of collection fees, which is standard practice in the private sector. This proposal would allow the Internal Revenue Service to recoup its cost of collecting delinquent amounts and would encourage taxpayers to pay more promptly. Like penalties, this fee would not be deductible to taxpayers." I don't believe that there is another section of the President's proposal that will effect every taxpayer, rich or poor, as will this one. The potential for the IRS to abuse this proposal is enormous, and I don't believe that this is what Americans had in mind when they expressed the view that our tax laws should be simplified. This proposal is too vague. As currently proposed, the provision leaves too much up to the discretion of the IRS.

Mr. Chairman, does this provision mean that if I owe the Internal Revenue Service $1,000 for ninety days, I could be charged a collection fee equal to the 25 to 50% that collection agencies in the private sector currently charge? Would I also be subject to legal fees? Is it the intention of the Service to turn over the collection of delinquent accounts to private collection agencies? This proposal is a departure from current business practices as we know them. The President's proposal will transfer the cost of collecting a debt from the creditor to the debtor. Mr. Chairman, this proposal should rightfully be called the David Copperfield Provision. It is one step removed from debtors prison.

Lastly, the Committee should consider providing small businesses with some type of exemption from the additional record keeping that will be required by Treasury II. The President's proposal requires that businesses separately track employee health insurance costs and the amount expended for business meals. I believe that some dollar threshold should be set before a deduction is denied for 50% of the meal cost above the $25 cap. I would like to suggest an exemption of $2,000 for the cost of business meals incurred by small businesses.

Additionally, I would like to suggest that firms with ten (10) or fewer employees be exempted from including, in an employees' gross income, either the $25 per month for family health insurance coverage or the $10 per month for individual coverage, as required by the President's proposal.

Mr. Chairman, I would like to thank you and the Committee, on behalf of The National Association of Enrolled Agents, for this opportunity to express my views on Treasury II. If you have any questions, I would be pleased to answer them.

The **Chairman**. Mr. Lewis, one of the positions that the American Bar Association has held for a number of years is that the premiums on employer provided legal plan should not be taxable as income to the employee. Is that still the position of the ABA?

Mr. **Lewis**. Yes, it is, Mr. Chairman.

The **Chairman**. That, of course, was not a provision in Treasury I. Under Treasury I, that benefit would have been taxed along with a number of others. The administration has since altered its position somewhat, but isn't that an example of a benefit that not all employees receive and therefore employees with equal incomes are going to be treated differently?

Mr. **Lewis**. I have to confess that it is. You have to understand that, as the representative of the association, I must support that provision regardless of what my personal views are.

The **Chairman**. In other words, your personal views are that that should be taxed?

Mr. **Lewis**. If I may speak for myself, I think it should be taxed. Yes.

The **Chairman**. Do you basically favor a flat tax with no deductions at all, or if not a flat tax, at least no deductions for anything at all and perhaps some kind of a progressive tax?

Mr. **Lewis**. I would not favor a flat tax, because I think the progressive element of our present system is a good one, and therefore, I think the three rate brackets proposed by the President and by the Treasury are useful in preserving that element of progressiveness. I do think, of course, that the people at or below the poverty level have to be excepted, and therefore, you do have to have deductions for that purpose. When you leave that——

The **Chairman**. You wouldn't necessarily have to have deductions. You could simply have a floor below which you don't tax.

Mr. LEWIS. Yes. Yes. You can do it by a floor. The only other thing I would want to say is that I think the income tax should be a tax for revenue only and that the system we have engaged in for the last 24 years, beginning with the Kennedy administration, of using the system to promote economic and social goals has been a failure.

The CHAIRMAN. But again, going back now to your hat for the ABA, they still continue to favor the nontaxable status of group legal plans?

Mr. LEWIS. Yes. Yes. I am a prisoner of that——

The CHAIRMAN. Do you know what the ABA's position would be then on identical provisions, but for health insurance instead of legal insurance?

Mr. LEWIS. I do not know what their position would be on that. I suspect that—if I may speak frankly and I will have my head handed to me when I go back uptown—the reason they support the legal insurance is because there are a lot of lawyers out there who think they will benefit from it. I don't think the lawyers would benefit from health insurance, and their view might be different.

The CHAIRMAN. I don't know if the ABA has a position on health insurance. I don't know if the AMA has a position on legal insurance.

Mr. LEWIS. I don't either. [Laughter.]

The CHAIRMAN. They each have a position on respectively health and legal insurance. Now, whether that is because that benefits their own groups or not. We are soon to have a panel representing the independent sector and charitable organizations who like using the Tax Code for charitable purposes. Would you also personally oppose that?

Mr. LEWIS. I think the Treasury's and the President's proposal to eliminate the charitable deduction for nonitemizers is a good provision. I think it will simplify tax compliance and administration. The standard deduction, now the zero bracket amount, is supposed to give them more than they would have if they could itemize.

The CHAIRMAN. But you are speaking for yourself now, not the ABA?

Mr. LEWIS. Every question you ask me, I am going to have to speak for myself.

The CHAIRMAN. All right. Do you think it is important to eliminate the difference between regular income and capital gains?

Mr. LEWIS. It is important from the standpoint of tax simplification. The capital gains provisions are the single most complicating provision in the code. That, of course, is not the whole story. I am not an economist, and I am unable to evaluate the argument that a lower rate for capital gains is necessary to produce venture capital. I do not know whether that is so or not, but I do think that the President—if we need special treatment of capital gains—has gone the wrong way. It would be much better, much simpler to have a lower ceiling rate instead of an excluded amount that cuts all the way down the scale and brings the capital gain complexity to the man in the 15-percent bracket by giving him a 7.5-percent rate.

The CHAIRMAN. Now, let me ask Mr. Ellentuck and Mr. Silverman, because you both commented about simplicity; have you ever had much complaint from those people who use the capital gains provisions about its evil because it was not simple?

Mr. Ellentuck. No, Mr. Chairman. I would say that where the benefit falls to the taxpayer, they are not prone to complain.

The Chairman. By motives of simplicity. Mr. Silverman.

Mr. Silverman. I would have to agree with that. My experience is the taxpayers who seem to benefit, it is a matter of complete indifference how complicated an item is.

The Chairman. Now, let me ask both of you, from the standpoint of preparing somebody else's taxes, is capital gains a particularly complex issue?

Mr. Silverman. Not really.

Mr. Ellentuck. I would say no. Capital gains is not one of the complexities. Taxpayers can understand it when we explain it to them.

The Chairman. Mr. Silverman.

Mr. Silverman. It is not especially complicated. It does get somewhat complicated when it starts triggering the alternative minimum tax, and that leads to a great deal of complexity. But in and of itself, I would answer no.

The Chairman. Senator Grassley.

Senator Grassley. Thank you, Mr. Chairman. Mr. Ellentuck, I believe you made the point about the repeal of cash accounting as it would effect to service organizations, lawyers, and accountants. Did you also consider that that would impact agricultural businesses, to the extent that farmers over the $5 million limit would not be allowed to utilize cash accounting. Was that an oversight, or do you believe that just the service organizations you mentioned would be adversely affected by this provision?

Mr. Ellentuck. No, Senator. I think we mentioned those that came to mind. There are many, many other types of service organizations that would be affected, including farmers.

Senator Grassley. All right. I would like the opinion of each of you, and I think Mr. Lewis alluded to the issue I would like to raise—the fact that we have had so many tax laws changes in the last several years. Let's suppose we were to pass a package as comprehensive as the President's proposal, although maybe not exactly the way he had it, but something that comprehensive. Do you believe such legislative change should then be setting the stage for a moratorium on tax legislation for a period of time? Would such a moratorium avert the adverse economic impact that you allude to in your statements that has resulted from so many tax bills in the last several years?

Mr. Silverman. Although you directed it at Mr. Lewis, I will go ahead. I think, Senator, you are probably the best judge of the political pressure placed on somebody for a change in the tax law. In my considered opinion, people have not really complained so much about complexity as they have about high tax rates.

The Chairman. As they have about what?

Mr. Silverman. High tax rates. This total provision—the proposal that the President has placed before the Congress—is not going to change one basic fact, and that is that the average American taxpayer works from January 1 to May 9 just to pay his Social Security, his Federal tax, and local taxes. From May 10 to the end of the year, he is working for himself, and this Treasury II, or the President's proposal, is not going to drastically change that fact.

Senator **Grassley**. I don't dispute that, but I was alluding to the statement that some of you made of the bad economic impact of so many changes in the tax law in recent years.

Mr. **Silverman**. I am not a judge of the economic impact, only as it adversely affects small businesses and the amount of extra expenditures that they have to put forth to comply with these changes and ever-increasing filings with the IRS and other Government agencies.

Senator **Grassley**. Mr. Ellentuck.

Mr. **Ellentuck**. Senator Grassley, we would certainly be delighted if there were a comprehensive change and that would put a rest to the frequency of future major tax legislation. Although I must say that, having seen other major reforms in prior years, we would approach that with a bit of skepticism. Other reforms have been rather comprehensive and then, the following year, we would see yet another major change.

Senator **Grassley**. Mr. Lewis.

Mr. **Lewis**. Senator Grassley, here I can speak for the ABA instead of individually. The ABA resolutions do express the hope that, if this comprehensive reform can be achieved, that then there would be a period of stability. Of course, I have to concede that every tax law will have bugs in it, and you will have to have a technical revision act to get rid of the bugs, but I would hope that then we could have a period of stability and that you and the House and Ways Committee would be able to resist people who show up asking for more change.

Senator **Grassley**. Mr. Chairman, I will just make a statement in closing my 5 minutes. During the recess, I had an opportunity to have an accounting firm come to one of my district offices in the State of Iowa to process any individual's income tax return who wanted to come into the office and find out if they would pay more in tax under the President's proposal or current law. I am going to repeat the program in four other places in my State of Iowa. I was a little surprised and will then hopefully have more definative results, at the impact of the proposed changes upon the elderly, and upon small farmers. Also, from my own standpoint, there isn't much tax simplification, and I don't think I have a particularly complicated tax return. My income, which is in part from agriculture, in part salary, from the Senate, and also in part self-employed, from honorarium income, only two lines would be eliminated my tax form. So, I guess I would suggest that I am somewhat disappointed that there is not going to be much more simplification. It might be reform, and it might be fairness, but I don't think it will make it much simpler for a lot of us who are in small business.

The **Chairman**. Senator Moynihan.

Senator **Moynihan**. I just want to agree with my colleague from Iowa. I would like to ask a few questions, Mr. Chairman, on which our distinguished panelists might want to comment. How did it come about that we increased the length of the Internal Revenue Code by almost half in the last 4 years? And how would you describe the dynamics of it all? I mean, we are talking about simplifying our code—the same administration, the same Congress, the same committee—which has already immensely complicated the code.

Mr. ELLENTUCK. My feeling, Senator Moynihan, is that this has come about through very good motives, through an effort to make things fairer. And as we are struggling with the code, we realize that fairness and simplicity don't often go together. When you try to make things fair, close loopholes, refine the code provisions, they get more complicated. And I think that is what has happened. There has been a lot of loophole closing. The code is fairer now than it was four years ago, but as you say, it is much longer and much more complicated.

Senator MOYNIHAN. We have that built-in difficulty.

Mr. ELLENTUCK. Yes.

Senator MOYNIHAN. Let me relate to you an incident from 1984. At 10 o'clock one night, as we were putting together the final touches of the 1984 tax bill, Senator Chafee of Rhode Island said, "You know, we now have a tax bill which is approximately 600 pages long, and it has as its object raising $150 billion over 3 years." Six hundred pages. He said, "We can get you $150 billion with one line. Just eliminate, or for 3 years postpone, indexation." And I seconded his proposal. Our previous chairman, the distinguished majority leader, said, "It was a good idea but that it was the killer amendment. The President would veto it." So, we adopted 600 pages instead of one line, as a matter of necessity. It takes 15 pages to describe something that only two lawyers understand, and only six people are smart enough, or rich enough, to take advantage of. And then it takes 15 pages to explain that you can't do it any more.

Wouldn't you agree that much of the proposal was really based on the absolute unwillingness of the President to agree to any revenue increases directly?

Mr. ELLENTUCK. I would say that this proposal is presented as revenue neutral, but my own feeling is that, in attempting to make it revenue neutral, there are revenue raising measures built in the proposal which add to complexity. We are looking at another 400 pages in the administration's proposal.

Senator MOYNIHAN. So, the net result of tax reform might be that we will double the length of the Internal Revenue Code in 5 years.

Mr. ELLENTUCK. Yes, I would say so.

Senator MOYNIHAN. But the American Bar Association surely can't oppose such a measure, can it?

Mr. LEWIS. I think there are some simplifying things that were proposed by Treasury, for example, in setting the corporate tax rate of 33 percent, about equal to the top individual rate. The Treasury noted it would be possible to get rid of the personal holding company provisions, which are a big item, and that it would also be possible to get rid of the provisions limiting a group of commonly controlled corporations to one set of the lower rates because there wouldn't be any lower rates. Those would both be very simplifying. The Treasury's elimination of the preference of capital gains would take maybe 400 pages out of the code. So, there is a lot of simplification there.

Senator **Moynihan**. I agree with you, Mr. Lewis, and I thank you all.

Mr. **Silverman**. Senator, I would just like to add something. I think you reached a rather valid conclusion. Even if this—the President's proposal does not pass, I think the committee should undertake some kind of housecleaning of the code. We have things on the books, like $100 dividend exclusion, and companies have to separately track that, whether it is qualifying or nonqualifying for the purpose of the exclusion, and I can't believe that eliminating that $100 would necessarily make anybody either rich or poor. We have six ways of treating pension income—a lump sum, and 10-year forwarding averaging—and I think a systematic housecleaning eliminating complexity—and not only that, we find conflicting—in this legislation, we might end up with a code section that conflicts with a prior code section. So, as a result, we end up in the courts trying to determine which is the controlling section.

Senator **Moynihan**. Thank you.

Mr. **Ellentuck**. We would repeat our recommendation for a national commission on simplification.

Senator **Moynihan**. That is an interesting thought. We thank you very much. Thank you, Mr. Chairman.

The Chairman. Senator Grassley, any other questions?

Senator **Grassley**. Just a short one. I think we need the benefit of your expertise in the area of the feasibility of the proposed return free system, as proposed by the President's bill.

Mr. **Silverman**. I don't think it is practical because the first bit of credit information that someone is asked for when they try to secure a loan is a copy of their tax return. So, that is engrained in our whole financial process. It is also the starting point for the taxation of State tax returns. And the State that I am from—New York—models itself or starts with Federal adjusted gross income. So, to secure a loan or to file their State tax return, taxpayers are going to need some document—what form it should take, I haven't thought that out at this point yet.

Mr. **Lewis**. I disagree with that. I think the return free system will work. I am aware of the Internal Revenue Service's current problems with its computer, but it will lick those problems, and I think the return free system is one that ought to come.

Mr. **Ellentuck**. We think the idea of the return-free system seems to be a good one. It has worked very well in Japan. We also see some problems and have some concerns with it, but it certainly merits careful consideration and study. It seems to be a good idea.

The Chairman. Gentlemen, thank you very much.

Mr. **Lewis**. Thank you.

Mr. **Silverman**. Thank you.

The Chairman. Now, we have a panel of Brian O'Connell, from the Independent Sector; Dr. Lorraine Hale, executive director of Hale House, accompanied by Mrs. Clara Hale; Dr. Charles Clotfelter, vice provost for academic policy from Duke University; Ms. Juliet Rowland from the United Way of Pennsylvania; Mr. Kenneth Keller, the president of the University of Minnesota; and Dr. Thomas Murnane from Tufts University. Unless the panel has any objection, we will go in the manner in which you are listed—unless you have worked it out some other way yourselves—all right? Mr. O'Connell, we will start with you.

STATEMENT OF BRIAN O'CONNELL, PRESIDENT, INDEPENDENT SECTOR, WASHINGTON, DC

Mr. O'CONNELL. Thank you, Mr. Chairman. More important than any oral summary is this opportunity to thank you for the leadership you have been providing over so many years on these issues.

The CHAIRMAN. I might say that Senator Moynihan and I obviously have a very, very paternalistic interest in the deductions for nonitemizers, having been the coauthors of that in 1981, and I think having seen it work reasonably well as we hoped it would work.

Senator MOYNIHAN. If I could say so, we held hearings on this last year. And it is 1 of the 2 times on this committee in a reasonable span of time that we have been able to set up a proposition, test it, and it turned out to be——

Mr. O'CONNELL. In my testimony, I will elaborate on that, but before getting into it, I also want to acknowledge your leadership, Senator Moynihan, particularly this year. Given Senator Packwood's responsibility here, you have carried this burden largely alone, and I want you to know that our 600 national members and their hundreds and thousands of local affiliates and their members—who number in the millions—are very much aware of the courageous leadership you are providing, and they are very grateful for it. That is the most important message I could deliver today. Thank you.

The CHAIRMAN. You don't need to testify any further. I don't think. [Laughter.]

Mr. O'CONNELL. I do have a few things to say, Mr. Chairman, but the gratitude and appreciation to the two of you comes first and foremost. Obviously, our organizations are very relieved and pleased that the President's proposal has dropped some of the earlier provisions of the so-called Treasury I, but as you know, the current President's proposal would still cause a loss of $11 billion, or almost 17 percent of charitable giving. That is largely due to the repeal of the charitable contributions law that you two have championed over the years. Mr. Lindsay of Harvard estimates that just dropping that provision—the CCL—the charitable contributions law, would result in a loss in giving of $7 billion. In addition, he says that lowering the marginal rates would cause another loss of about $4 billion. As we have said consistently, we are willing to choke down, suffer, take the loss of giving as it relates to marginal tax rates, if that is the will of Congress. But I have to tell you—as you two would know—that we are not willing to accept the additional loss of $7 billion relating to loss of the charitable contributions law and other provisions. It is important always in this context to point out that people do not—do not—give to the causes of their choice because of tax considerations. They give for all of the beautiful reasons of wanting to help communities and causes and people, but the fact of the tax deduction does increase the size of enough gifts to represent an increase in giving of about one-third, or 31 percent to be exact, over what would be given if there were

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no deduction for contributions. Consistent with what the two of you were saying, it is fascinating, and it is good news and bad news, that as you take a look at the results from 1981 forward, as a result of lowering the marginal rates and introducing the charitable contributions law, that as a result of lowering the rate since 1981, giving among persons with incomes above $50,000 has dropped dramatically. Among incomes of $100,000, giving has dropped almost 20 percent. The good news, though, is that your charitable contributions law has more than offset that dramatic loss. Giving went up 11 percent in that same period, that is, each of the years in that same period, largely because giving by persons with incomes under $30,000—those who benefit by the charitable contributions law—has risen dramatically. The bad news is the marginal rate drop has impacted giving among the wealthy, but the increased giving of low- and middle-income people has more than offset that. Just as important, it is terribly vital—it is terribly good news—that for the first time in 10 years, even in the face of that marked decrease in giving by upper income people, for the first time in 10 years, giving as a proportion of personal income has not declined as a society: it has gone up. Giving and volunteering in this country are universal values, and you two know so well that poor people, middle-income people are often the stalwarts—the givers, the volunteers. As you know, givers are volunteers, and the small giver is the big giver of the future. The principle of fairness does dictate that all taxpayers should be able to deduct their contributions. The principle of fairness should clearly dictate that the voluntary organizations that are being asked to carry an increased part of the load of the delivery of services should not be penalized on the tax side at the very time they are trying to respond to the public's need for increased services. The administration says we have all got to do our own share, but as nearly as we can tell, we were the only ones to respond 4 years ago when, in the face of deficits, they asked us to phase in that charitable contributions law of yours and ours. We went along with that, and now 4 years later, they are saying, well, give it all up, and we are saying that is not fair. We responded and we responded well. The Government has pushed the workload on us, and we responded. And we have shown restraint at the request of Government, and now we are being asked to make a further sacrifice. I can tell you we don't mind being known as softhearted, but we are angered when people treat us as softheaded. The issue comes down clearly to what kind of a society we are going to be, and we say tax policy should reflect good social policy. Thank you.

[The prepared statement of Mr. O'Connell follows:]

INDEPENDENT
SECTOR

TESTIMONY

of

Brian O'Connell
President
INDEPENDENT SECTOR

on

The Impact of the President's Tax Proposals on Charities

before the

Senate Finance Committee

July 9, 1985

A NATIONAL FORUM TO ENCOURAGE GIVING, VOLUNTEERING AND NOT • FOR • PROFIT INITIATIVE
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SUMMARY OF TESTIMONY BY BRIAN O'CONNELL

The new tax plan offered by President Reagan acknowledges the vital role played by giving and volunteering in our society. Unfortunately, that same tax plan threatens to narrow the support for services provided by charitable organizations by abandoning the principle that the tax laws should treat all gifts to charity the same, regardless of the size of the gift or the wealth of the donor.

INDEPENDENT SECTOR is encouraged that the President has rejected several provisions from the earlier Treasury tax proposal which would have even more sharply reduced charitable giving. However, the new plan will reduce dramatically the number of taxpayers who will be able to deduct their gifts to charity. Present law allows all taxpayers, regardless of income level or size of gift, to receive a tax deduction. The new plan would permit a tax deduction only by those with the highest incomes who itemize their other deductions, estimated to be only one out of four taxpayers.

Even with the changes made from the original Treasury proposal, contributions in 1986 to carry out services provided by charities would be reduced by about 17 percent or $11 billion over what would be the case under the current law. Services given by charities would be cut that amount even after taking into full account that the President's tax reform plan will leave many taxpayers additional discretionary income, some of which will be contributed to charity.

Studies by Professor Lawrence Lindsey of Harvard University show that once the new plan is in place, only approximately 24 percent of the taxpayers will be able to take a deduction for contributions, down from 100 percent under present law (Some estimates suggest that in the near future only 10 or 15 percent of taxpayers will itemize). Estimates are that this narrowing of the deduction alone will cause a decrease in charitable giving of $6.7 billion annually. In addition, Professor Lindsey concludes that charitable giving will decline by $4.2 billion in 1986 as a direct result of lowering marginal tax rates and other tax changes (including gifts of appreciated property for individuals subject to the minimum tax). Other research, conducted by Dr. Charles Clotfelter, Vice Provost of Duke University, found that services offered by charities would be cut by about $11 billion under the President's proposal.

As part of contributing our fair share to tax reform, INDEPENDENT SECTOR accepts the reductions in charitable giving which result from lowered marginal tax rates. We are not willing, however, to accept additional reductions.

Though the relationship of taxes and giving is important, as illustrated by the studies, INDEPENDENT SECTOR points out that people do not give to the causes of their choice because of tax considerations. The larger motivations relate to helping others and improving communities. However, the charitable deduction does influence the size of enough gifts to represent a 31 percent increase over what would be given if the deduction did not exist.

INDEPENDENT SECTOR points out that giving does not represent any financial advantage to the giver. Contributions still represent a subtraction from what could be spent on other things. The deduction for contributions is the only deduction that provides no tangible benefit to the taxpayer. These are not dollars consumed or saved. They are voluntarily contributed for the public good.

Giving and volunteering in this country are universal virtues. Charity is everyone's concern and everyone's responsibility. The new plan undermines this principle by making tax distinctions between those who give a lot and those who can give only a little. Charitable organizations know the importance of the small giver, as well as those who can afford to give more. The small giver, like others who give, is a volunteer. The small giver is the larger giver of the future. The small giver is often the unsung supporter in the community of the charity's goals and programs.

The principle of treating all charitable gifts the same under the tax law is a matter of tax fairness. This principle was recognized by Congress when it adopted in 1981 the present tax treatment of gifts made by those who do not itemize their deductions. It is recognized by Congress today as evidenced by the fact that a majority of the Members of the House of Representatives already co-sponsor H.R. 587 which will make permanent the deduction of contributions by all taxpayers.

This principle was recognized by then-candidate Ronald Reagan in 1980 when he stated in a communication to the National Conference of Catholic Charities,

> "To help nongovernmental community programs aid in serving the needs of poor, disabled, or other disadvantaged, we support permitting taxpayers to deduct

> charitable contributions from their Federal income tax whether they itemize or not."

Any reductions in charitable giving would only compound the impact of Federal budget cuts since 1982. In cumulative figures, overall federal spending on human service programs declined by $50 billion between 1982 and 1985, excluding Medicaid and Medicare. In the last four years there has been a decrease in government involvement in a number of human service programs. Proposed changes in the tax treatment of gifts to nonprofits reduce the possibility for private initiatives to offset at least part of the impact of federal cutbacks.

The President's recommendations contradict totally this Administration's call for volunteers and voluntary organizations to play a larger role in helping people deal with human problems, community needs, and national aspirations.

For a country -- and an Administration and Congress -- that wants to encourage private initiative for the public good, passage of H.R. 587 and S. 361 to continue the charitable deduction is terribly important.

Whatever occurs as the result of current efforts related to tax reform must not intentionally reduce governmental encouragement of voluntary endeavor. Any such move would negate the larger public policy consideration, which, from the start, has been to foster the vast participation and diversity that are so much a part of America's uniqueness.

FULL TESTIMONY OF BRIAN O'CONNELL

INTRODUCTION

I am Brian O'Connell, President of INDEPENDENT SECTOR, a membership organization of 625 national organizations, foundations, and business corporations which have banded together to strengthen our national tradition of giving, volunteering and not-for-profit initiative. A list of our members is attached.

Our Voting Members are organizations with national interest and impact in philanthropy, voluntary action and other activity related to the independent pursuit of the educational, scientific, health, welfare, cultural and religious activities of the nation. The range of members includes the American Heart Association, United Negro College Fund, Goodwill Industries of America, Kellogg Foundation, National Council of Churches, Native American Rights Fund, Association of Junior Leagues, CARE, Council on Foundations, American Association of Museums, Council of Jewish Federations, National Puerto Rican Coalition, National Conference of Catholic Charities, National Audubon Society, Equitable Life Insurance Society of the U.S., National Association of Independent Colleges and Universities, United Way of America, Brookings Institution, American Enterprise Institute, Appalachian Mountain Club, and the American Red Cross. The common denominator among this diverse mix of organizations is their shared determination that the voluntary impulse shall remain a vibrant part of America.

THE HISTORY OF TAX POLICY IN RELATION TO CHARITABLE GIVING

Historically, tax policy has encouraged voluntary initiative. From the beginnings of our country, deliberate effort has been made to encourage private initiative for the public good and to promote and sustain the voluntary institutions through which the nation does so much of its public business. Those conscious efforts included the property tax exemption and, when the modern day Federal income tax was adopted, the charitable contributions deduction.

The action of Congress in 1917 to provide for the charitable contributions deduction was a clear indication that we wanted to find every conceivable way to encourage pluralism and maximum possible involvement of citizens in addressing their own problems and aspirations. When the Congress extended the deduction for nonitemizers, in 1981, it was further indication that it is the position of the American people and our government that all of us should be encouraged in every way possible to support the causes of our choice.

RECENT CHANGES IN CHARITABLE GIVING

Charitable contributions increased by 11 percent in 1983 even after the 1981 Tax Act had reduced marginal tax rates. However, Treasury figures show a decline in giving among upper-income earners, but these declines have been offset by increased giving among lower-income families, particularly those with incomes under $30,000, the large group allowed to deduct the charitable contributions by the same 1981 Tax Act. During the period 1980 to 1983, the average contribution per return by individuals making less than $50,000 per year increased by 18 percent -- due in part to the availability of the charitable deduction for nonitemizers. In 1982, 91 percent of those taking the charitable deduction for nonitemizers had incomes of less than $30,000. Ninety-nine percent had incomes under $50,000. During the 1980 to 1983 period, the average contribution per return by individuals making over $50,000 actually decreased by 34 percent -- due in large part to the reduction in marginal tax rates resulting from the 1981 Tax Act.

Not only did giving by individuals rise by almost 14 percent in 1983, a tough economic year and one in which giving in the upper brackets declined so dramatically, but for the first time in 12 years, giving as a proportion of Personal Income (PI) began to rise after 10 straight years of decline. Not only did the trend reverse, it did so in a dramatic turnaround, bringing it to its highest level since 1971. These are the figures from "Giving USA - 1986" produced by the American Association of Fund-Raising Counsel, Inc.:

GIVING BY INDIVIDUALS

Year	Amount (billions)	Personal Income (billions)	Percent of Income
1970	$16.19	$ 811.1	2.00
1971	17.64	868.4	2.03
1972	19.37	951.4	2.04
1973	20.53	1,065.2	2.04
1974	21.60	1,168.6	1.93
1975	23.53	1,265.0	1.85
1976	26.32	1,391.2	1.89
1977	29.55	1,540.4	1.92
1978	32.10	1,732.7	1.85
1979	36.59	1,951.2	1.88
1980	40.71	2,165.3	1.88
1981	46.42	2,429.5	1.91
1982	48.52	2,584.6	1.88
1983	55.13	2,744.2	2.01
1984	61.55	3,013.2	2.04

A law of major importance to the 800,000 public charities and to the 62 million taxpayers who won't, under current law, itemize their income tax in 1986, was enacted in August, 1981, as a part of the 1981 Tax Act. That measure, the Charitable Contributions Law, allows a taxpayer to take a deduction for contributions to charity even if the giver takes the standard deduction. According to recent research, the law will generate $5.5 billion annually in increased contributions to charities.

Between 1970 and 1980, the zero bracket amount (Z.B.A.) for married couples filing jointly was increased from 1,000 to $3,400. As the Z.B.A. has increased, fewer and fewer taxpayers have elected to itemize their deductions. The gradual increase in the Z.B.A. between 1970 and 1980 resulted in a loss of $5 billion in contributions to public charities.

Charitable contributions may have been taken into account as part of the standard deduction when the legislation was originally considered 30 years ago. Since that time, however, the level of the standard deduction has been raised a number of times without regard to estimates of individual components. The critical point is that the use of the standard deduction or Z.B.A. was never intended to discourage charitable giving; yet, inadvertently, it did.

REVENUE LOSS, DEFICITS, AND CHARITABLE GIVING

In the face of rising deficits, it was important to keep the loss to the Treasury low in the first several years of the charitable deduction for nonitemizers. The philanthropic community recognized the need to address the deficit problem and agreed to the phase-in.

1982 - 25 percent of 1st $100 (maximum of $25)
1983 - SAME
1984 - 25 percent of 1st $300 (maximum of $75)
1985 - 50 percent of all contributions
1986 - 100 percent of all contributions

The Treasury Department says that the deduction will cost them $2.7 billion in 1987. Professor Clotfelter, Martin Feldstein and other economists predict that the deduction will increase contributions by a good deal more than that. According to Lindsey of Harvard University, giving is likely to increase by at least $5.5 billion, if the charitable deduction for nonitemizers is continued.

Five and one-half billion may not seem like much to a government with a budget of $1 trillion, but it's still an awful lot of money in this voluntary sector. It's more than twice the money raised throughout the country in last fall's United Way appeal.

Conversely, the Treasury loss of $2.7 billion is about one-quarter of one percent of the Federal budget. Compare in your own mind the tradeoff between expanding all voluntary effort in our society by almost ten percent contrasted with reducing Federal expenditures by one-quarter of one percent. And match that against the widespread determination to expand citizen participation in our communities and the nation.

Even if the $2.7 billion were taken from charities and used to reduce the Federal deficit of $200 billion, it would be less than one and one-half percent of the deficit. And that only compares dollars to the Treasury against dollars to voluntary organizations. It doesn't count the increased volunteering that goes with contributions and which contributions generate. For an Administration, a Congress and a nation that reveres pluralism and citizen involvement, it's the ultimate absurdity to be debating cutting the voluntary sector by ten percent to save the government one-quarter of one percent.

The Administration says that charities and people they serve should let the charitable deduction for nonitemizers be repealed even before the potential benefits of the deduction operating at its full level can be realized. That's the same government that is asking voluntary organizations to respond to greater demands as a result of cutbacks in government-run programs. Many voluntary programs have been hit by a triple whammy. The government is paying out less for public services contracted with voluntary agencies such as for day care. Contributions among the well-to-do have been reduced as a result of lowered tax rates and caseloads are being transferred from government agencies to voluntary ones.

The Administration says that all must do their share, but as nearly as we can see, we were the only ones to respond to their similar appeal four years ago when, in recognition of the deficit and with the assurances that the new Administration would find other ways to strengthen voluntary effort, we agreed to a slow phase-in of the nonitemizer deduction so that its full impact on the budget would not be felt at once. Now having responded with the agonizing restraint required of waiting for the deduction to phase-in to a level where it could help us with increased caseloads, we are the ones being asked to give it all up. That's not fair.

The government pushed the workload on us and we accepted. The government asked us to set an example of restraint in the face of national deficits and we accepted. Four years later, after being the ones to carry forward the voluntary spirit heralded by the Administration and Congress, we are the very same ones being asked to transfer almost ten percent of our income to provide the government with a supplement of one-fourth of one percent to theirs. We are rather proud to be known as soft-hearted, but rather angered to be treated as soft-headed.

If the primary interest of Treasury is to save money, let them ponder what it would cost them to take over responsibility for programs and institutions now funded by contributions. It would add at least $100 billion to the deficit and dry up the voluntary spirit that they say is the heart of our country.

PUBLIC AND CONGRESSIONAL SUPPORT FOR CHARITABLE DEDUCTIONS

The nonitemizer deduction enjoys a wide base of public and Congressional support. In this Congress, H.R. 587 is the only tax-related bill, out of 253 pending in the House, to have achieved a majority of cosponsors.

Two recent public opinion polls demonstrated strong support for charitable deductions in tax reform proposals. A January 1985 New York Times/CBS News poll showed that 81 percent believed that people should get the charitable deduction. A more recent Los Angeles Times poll supported keeping the deduction for giving to charity by an overwhelming 82 percent. Even among those who don't claim charitable deductions, 70 percent favored keeping the tax incentive, suggesting they think its social value outweighs their personal interest. The findings of both polls are consistent with a November 1984 Gallup survey, in which 80 percent of those queried stated that any tax reform proposal should either maintain the current charitable contributions deduction, or increase it.

OTHER BILLS

Any tax reform proposal considered by this Committee must not intentionally reduce governmental encouragement of voluntary endeavor. In addition to the President's tax proposals, other tax bills introduced in this session affect charitable giving. INDEPENDENT SECTOR is pleased that the Bradley-Gephardt bill retains the charitable deduction for all taxpayers. Unfortunately, the charitable deduction only applies at the basic rate of 14 percent. Dr. Clotfelter estimates that this bill would result in a decrease in giving of about 23 percent (versus 17 percent in the President's proposal). The DeConcini bill has no provision for a charitable deduction; contributions under that plan would be roughly one-third lower than current levels. The Kemp-Kasten bill would, like Bradley-Gephardt, retain the deduction for all taxpayers, though the top tax rate would be cut by 25 percent; contributions would fall on the order of 12 to 15 percent.

CONCLUSION

Any move which might to any degree stifle voluntary initiative would negate the larger public policy consideration, which, from the start, has been to foster the vast participation and diversity that are so much a part of America's uniqueness. For example, the President's recommendations contradict totally this Administration's call for volunteers and voluntary organizations to play a larger role in helping people deal with human problems, community needs, and national aspirations. For a country -- and an Administration and Congress -- that wants to encourage private initiative for the public good, that law is terribly important.

The issue comes down to what kind of society we want to be and a resolve to use public policy to encourage that vision. If pluralism is part of that ideal, then it is absolutely essential to search out every possible way to encourage it. The deduction of charitable gifts has provided a significant incentive for increased giving, but even more important has served to remind all of us that it is the philosophy and policy of the people and our government, that giving is an act for the public good that is to be fostered. These direct and indirect encouragements have helped to build the enormous degree of pluralism and citizen participation that are among the country's most important characteristics. Retaining the nonitemizer deduction and making the Charitable Contributions Law a permanent part of tax policy represents a small price and large step toward a more caring and participatory population. Charities are willing to accept significantly decreased charitable giving that will result from lowered marginal tax rates. We are accepting the burden of providing some of the services no longer financed by Federal tax dollars. We will not accept the repeal of the charitable deduction for three out of four taxpayers.

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Equitable Life Assurance Society of the United States
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GrandMet USA, Inc.
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Grotto Foundation
Grumman Corporation
GTE Corporation
Gulf + Western Foundation
George Gund Foundation
Alan Guttmacher Institute
Miriam and Peter Haas Fund
Walter and Elise Haas Fund
Hallmark Cards, Inc.
Luke B. Hancock Foundation
Hawaiian Foundation
Edward W. Hazen Foundation
Healing Community
Hearst Foundation, Inc.
William Randolph Hearst Foundation
H.J. Heinz Company Foundation
Heublein Foundation, Inc.
William and Flora Hewlett Foundation
Hewlett-Packard Company Foundation
Conrad N. Hilton Foundation
Hispanic Information and Telecommunications Network
Hispanic Policy Development Project
Hoffmann-LaRoche Foundation
Hogg Foundation for Mental Health
Honeywell Foundation
Hospital Research and Educational Trust
Hudson-Webber Foundation
Hunt Foundation
Huntington's Disease Foundation of America
Godfrey M. Hyams Trust
IBM Corporation
Independent College Funds of America, Inc.
Independent Research Libraries Association
Inland Steel-Ryerson Foundation, Inc.
Institute for the Future
Institute for Journalism Education
Institute of Current World Affairs
InterAction (American Council for Voluntary International Action)
International Christian Youth Exchange
International Paper Company Foundation
International Service Agencies
International Women's Health Coalition
INTERPHIL (International Standing Conference on Philanthrophy)
Interracial Council for Business Opportunity
James Irvine Foundation
Irving Trust Company
ITT Corporation
Ittleson Foundation
Japan-America Student Conference, Inc.
Jerome Foundation
Johnson Foundation, Inc.
Johnson & Johnson
Robert Wood Johnson Foundation

Joint Action in Community Service
Joint Center for Political Studies
Joint Council on Economic Education
Jones Foundation
Jostens Foundation, Inc.
Joyce Foundation
Junior Achievement Inc.
JWB
Kaiser Aluminum & Chemical Corporation
Henry J. Kaiser Family Foundation
Keep America Beautiful, Inc.
W.K. Kellogg Foundation
Charles F. Kettering Foundation
Kresge Foundation
Samuel H. Kress Foundation
Albert Kunstadter Family Foundation
LEAD Program in Business, Inc.
League of Women Voters Education Fund
L.S.B. Leakey Foundation
Leukemia Society of America, Inc.
Eli Lilly and Company
Lilly Endowment, Inc.
Lubrizol Foundation
Henry Luce Foundation, Inc.
Lutheran Brotherhood Foundation
Lutheran Council in the USA
Lutheran Resources Commission - Washington
Lyndhurst Foundation
J. Roderick MacArthur Foundation
John D. and Catherine T. MacArthur Foundation
R.H. Macy & Co., Inc.
March of Dimes Birth Defects Foundation
John and Mary R. Markle Foundation
Louis B. Mayer Foundation
Robert R. McCormick Charitable Trust
McDonald's Corporation
McDonnell Douglas Corporation
McGraw-Hill Foundation, Inc.
McKesson Foundation, Inc.
McKnight Foundation
Meadows Foundation
Medina Foundation
Mellon Bank Foundation
Richard King Mellon Foundation
Joyce Mertz-Gilmore Foundation
Metropolitan Life Foundation
Mexican American Legal Defense and Educational Fund
Mexican American Women's National Association
Eugene and Agnes E. Meyer Foundation
John Milton Society for the Blind
Minneapolis Foundation
Mobil Oil Corporation
Monsanto Company
Philip Morris, Inc.
Charles Stewart Mott Foundation
Stewart R. Mott Charitable Trust
Mountain Bell
Ms. Foundation for Women, Inc.
Mutual Benefit Life
Mutual of America Life Insurance Company
NAACP Legal Defense and Educational Fund, Inc.
National Academy of Public Administration
National Action Council for Minorities in Engineering, Inc.
National Alliance for the Mentally Ill
National Alliance of Business
National ALS Foundation, Inc.
National Assembly of Local Arts Agencies
National Assembly of National Voluntary Health and Social Welfare Organizations, Inc.
National Assembly of State Arts Agencies
National Association for Bilingual Education
National Association for Hispanic Elderly
National Association for Hospital Development
National Association for Visually Handicapped
National Association of Area Agencies on Aging
National Association of College and University Business Officers
National Association of Community Health Centers, Inc.

National Association of Independent Colleges and Universities
National Association of Independent Schools
National Association of Latino Elected and Appointed Officials (NALEO)
National Association of Public Television Stations
National Association of Schools of Art and Design
National Association of Schools of Music
National Association of Schools of Public Affairs and Administration
National Association on Drug Abuse Problems, Inc.
National Audubon Society
National Black Media Coalition
National Board of the Young Women's Christian Association of the U.S.A.
National Catholic Development Conference, Inc.
National Charities Information Bureau, Inc.
National Committee Against Discrimination in Housing
National Committee for Adoption, Inc.
National Committee for Citizens in Education
National Committee for the Prevention of Child Abuse
National Concilio of America
National Conference of Catholic Charities
National Congress for Community Economic Development
National Congress of American Indians
National Consumers League, Inc.
National Corporate Fund for Dance, Inc.
National Council for Families and Television
National Council for International Visitors
National Council for Research on Women
National Council of the Churches of Christ in the U.S.A.
National Council of La Raza
National Council of Senior Citizens
National Council of Women of the United States, Inc.
National Council of Young Men's Christian Associations
National Council on Foreign Language and International Studies
National Council on U.S.-Arab Relations
National Down Syndrome Association
National Easter Seal Society, Inc.
National Executive Service Corps
National Family Planning and Reproductive Health Association, Inc.
National Federation of Business and Professional Women
National Federation of State Humanities Councils
National Foundation for Long Term Health Care
National 4-H Council
National Fund for Medical Education
National Future Farmers of America, Inc.
National Gay Task Force, Inc.
National Health Council, Inc.
National Hispanic Scholarship Fund
National Home Library Foundation
National Image, Inc.
National Indian Youth Council
National Institute for Music Theatre
National Job Corps Alumni Association, Inc.
National Legal Aid and Defender Association
National Medical Enterprises, Inc.
National Medical Fellowships, Inc.
National Mental Health Association
National Multiple Sclerosis Society

National Municipal League/Citizens Forum on Self-Government
National Neighborhood Coalition
National Neighbors, Inc.
National Network of Grantmakers
National Network of Runaway and Youth Services, Inc.
National Park Foundation
National Parks and Conservation Association
National Press Foundation
National Psoriasis Foundation
National Public Radio
National Puerto Rican Coalition, Inc.
National Puerto Rican Forum, Inc.
National Scholarship Service and Fund for Negro Students, Inc.
National School Volunteer Program, Inc.
National Society for Children and Adults with Autism
National Society of Fund Raising Executives
National Society to Prevent Blindness
National Space Institute
National Trust for Historic Preservation
National Urban Coalition
National Urban Fellows, Inc.
National Urban League, Inc.
National Wildlife Federation
Native American Rights Fund
Nature Conservancy
New Haven Foundation
New World Foundation
New York Community Trust
New York Life Foundation
New York Times Company Foundation, Inc.
NL Industries Foundation, Inc.
Nordson Foundation
Northwest Area Foundation
NOW Legal Defense and Education Fund
NYNEX
Oakleaf Foundation
OICs of America, Inc.
Older Women's League
Olin Corporation
Open Space Institute
OPERA America
Organization of Chinese American Women
Orleton Trust Fund
Outward Bound, Inc.
Owens-Illinois, Inc.
Pacific Telesis Group
David and Lucile Packard Foundation
Parents Anonymous
Parents Without Partners
J.C. Penney Company, Inc.
People-to-People Health Foundation, Inc. (Project HOPE)
Pepsico Foundation, Inc.
Permanent Charities Committee of the Entertainment Industries
Petro-Lewis Corporation
Pfizer Foundation, Inc.
Phillips Petroleum Foundation, Inc.
James Picker Foundation
Pillsbury Company Foundation
Pioneer Hi-Bred International, Inc.
Piton Foundation
Pittsburgh Foundation
Planetary Society
Planned Parenthood Federation of America, Inc.
Polaroid Foundation, Inc.
Population Council
Population Crisis Committee/Draper Fund
Population Resource Center
PPG Industries Foundation
Premier Industrial Foundation
Procter and Gamble Fund
Project Orbis, Inc.
Prudential Foundation
Public Affairs Council
Public Education Fund
Puerto Rican Legal Defense & Education Fund, Inc.
Ray Foundation
RCA Corporation
Reading is Fundamental, Inc.
Reinberger Foundation
Charles H. Revson Foundation
R.J. Reynolds Industries, Inc.
Sid W. Richardson Foundation
Rockefeller Brothers Fund
Rockefeller Family Fund
Rockefeller Foundation

Rockwell International Corporation Trust
Rosenberg Foundation
Round Table Foundation
RP Foundation Fighting Blindness
Samuel Rubin Foundation
Safeco Insurance Companies
Russell Sage Foundation
St. Paul Companies, Inc.
Saint Paul Foundation
Salvation Army
San Francisco Foundation
Santa Fe Southern Pacific Foundation
Save the Children
Schering-Plough Corporation
Dr. Scholl Foundation
Scientists' Institute for Public Information
Sears, Roebuck and Co.
Seaver Institute
Second Harvest
Shell Companies Foundation, Inc.
Sherwin-Williams Company
Lois and Samuel Silberman Fund
Alfred P. Sloan Foundation
Smart Family Foundation
John Ben Snow Foundation, Inc.
Southern Education Foundation
Southwestern Bell Foundation
Spencer Foundation
Spring Hill Center
SRI International
Standard Oil Company (Ohio)
W. Clement and Jessie V. Stone Foundation
Aaron Straus and Lillie Straus Foundation, Inc.
Levi Strauss Foundation
Student Conservation Association, Inc.
Sun Company, Inc.
Support Center
Syntex (U.S.A.), Inc.
Taconic Foundation, Inc.
Tandy Corporation/Radio Shack
Teachers Insurance and Annuity Association of America/College Retirement Equities Fund (TIAA-CREF)
Tektronix Inc./Tektronix Foundation
Telecommunications Cooperative Network
Tenneco Inc.
Texaco Inc.
Textron Inc.
Theatre Communications Group, Inc.
3M Company
Time Inc.
Times Mirror Foundation
Transamerica Corporation
Trebor Foundation
Trilateral Commission
Trust for Public Land
TRW, Inc.
Union Carbide Corporation
Union Pacific Foundation
United Jewish Appeal
United Negro College Fund
United Parcel Service of America, Inc.
United States Catholic Conference
United States-China Educational Institute
United States Committee for UNICEF
United States Olympic Committee
United States Steel Foundation, Inc.
United Way of America
Upjohn Company
Urban Institute
Urban Investment and Development Company
VOLUNTEER - The National Center
Volunteers of America
Wain Foundation
Izaak Walton League of America
Warner Communications, Inc.
Washington Center
Washington Post Company
Weingart Foundation
Wells Fargo Foundation
Westinghouse Electric Corporation
Weyerhaeuser Company Foundation
Weyerhaeuser Foundation, Inc.
Mrs. Giles Whiting Foundation
Amherst H. Wilder Foundation
Women and Foundations/Corporate Philanthropy
Women in Community Service, Inc.
Women's Action Alliance, Inc.
Women's Equity Action League (WEAL)
Women's Foundation
Woods Charitable Fund, Inc.
World Vision
World Wildlife Fund, Inc.
Wyman Youth Trust
Xerox Corporation
Zayre Corporation
Zellerbach Family Fund

The CHAIRMAN. Thank you. Dr. Hale.

STATEMENT OF DR. LORRAINE HALE, EXECUTIVE DIRECTOR, HALE HOUSE CENTER, INC., NEW YORK, NY

Dr. HALE. Good morning. Mr. Chairman and members of the committee, I would like to introduce you to my mother and founder of Hale House, Mrs. Clara Hale.

The CHAIRMAN. Welcome.

Dr. HALE. My name is Lorraine Hale, and I am the executive director of Hale House. Hale House is located at 154 West 122d Street in New York City. It is indeed an honor and pleasure to have been invited here to testify before the Senate Finance Committee. It is a double pleasure as this opportunity comes after a successful resolution of the hostage crisis. It is also a delight to see that Senator Moynihan of New York is sponsoring S. 361, along with Senators Grassley and Symms. This bill will make the charitable deductions for nonitemizers a permanent part of the Tax Code. The Senator has been a friend of Hale House in the past and has shown continued interest in our endeavors. We are also thankful to Senator Robert Packwood of Oregon, chairman of the Finance Committee, who has throughout the years steadfastly supported this bill. The Hale House Center for the Promotion of Human Potential was founded in 1969 as a home for young children born to narcotic-addicted parents. The Hale House goal includes a provision for care of the children while their parents undergo drug rehabilitation. Reuniting them with their families and research to understand the long-term effects of addictive drugs in infants' growth and development takes money. We are not a program that gets big grants from anyone. As a matter of fact, we began as a poverty program, sponsored by the Office of Economic Opportunity, and that was refunded, and we became a drug rehabilitation program at the time when folks said babies are not born addicted and therefore they are not drug addicts. And then, we became a tax levy program, and presently we are a licensed voluntary child care agency. These 15 years that we have been in business have been difficult, and it was only because of small donors that we have been able to sustain ourselves. I would like to tell you a short anecdote. About 7 years ago, we were—all of our staff were paid on probably a Tuesday, and everyone went to the bank at the same time. When they came back—they had been in the house about 5 minutes—and robbers came in. And because we have an open door policy, the robbers walked in, and they were admitted by one of the staff. And they had everyone come into the kitchen and they made them undress and they did all those terrible things that robbers do. They went up to my mother's room—who wasn't home—and there was a 79-year-old friend of hers sitting with a baby in her arms in a rocking chair. The bullet hole is still in the rocking chair because they did shoot in the chair because this 79-year-old woman was not able to get up fast enough for them, and they took her down with the baby, and they were not nice. This information got out because we called the police. It was on the police blotter. It was a Tuesday before Thanksgiving. The Friday after Thanksgiving we had been given back all of the money that

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had been taken, and we were able to give our staff the money that the robbers had taken from them. That was the good part of the story, and I say this because the money did not come in thousands of dollars or hundreds of dollars. It was nickel and dimes, and these are the same people who, obviously, do not itemize. And we are here to say please. We don't need it for the small contributors. They can't afford it. They don't itemize. And I see a yellow light, and I am already very nervous, so if you don't mind, I will say God bless all of you, and thank you so much for having us here.

The Chairman. Thank you. We are delighted to have you and your mother with us.

Dr. Hale. Thank you.

[The prepared written statement of Dr. Hale follows:]

HALE HOUSE CENTER, INC.
ADMINISTRATIVE OFFICES
68 EDGECOMBE AVENUE, SUITE 1
NEW YORK, NEW YORK 10030
(212) 690-5623 / 4

STATEMENT

MRS. CLARA HALE FOUNDER AND DIRECTOR OF HALE HOUSE

DR. LORRAINE E. HALE, EXECUTIVE DIRECTOR OF HALE HOUSE

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE
TUESDAY, JULY 9, 1985
9:30 a.m.

RE: IMPACT OF TAX REFORM ON CHARITABLE GIVING

Summary of
Dr. Lorraine E. Hale Testimony

We fully support S-361, the bill sponsored by Senators Moynihan, Grassley and Symms to make the charitable deduction for nonitemizers a permanent part of the tax code.

Private donations are, after all, the bread and butter of an agency like Hale House.

The Hale House Center for the Promotion of Human Potential was founded in 1969 as a home for young children born to narcotics-addicted parents. We depend on people with low to middle incomes for assistance. The small contributions given by those with modest incomes provide very necessary support for this agency and the children we help.

President Reagan has stated that government should stay out of the private sector, and he encourages the citizens to take more interest in supporting local agencies in the community. Since charity begins at home we depend on the charitable nature of our community and country to help us survive as a viable and useful community care giver.

We, the small agencies, who receive small donations from around the country will suffer the most. In turn, our children and our society will be the loser.

STATEMENT OF DR. LORRAINE E. HALE

Mr. Chairman, and Members of the Committee, I would like to introduce you to my mother and Founder of Hale House, Mrs. Clara Hale.

My name is Dr. Lorraine E. Hale, Executive Director of Hale House. Hale House is located at 154 West 122 Street, in New York City.

It is indeed an honor and pleasure to have been invited to testify before the Senate Finance Committee. It is a double pleasure as this opportunity comes after the successful resolution of the hostage crisis.

It is also a delight to see that Senator Moynihan of New York is sponsoring S-361 along with Senators Grassley and Symms. This bill will make the charitable deductions for nonitemizers a permanent part of the tax code. The Senator has been a friend of Hale House in the past and has shown continued interest in our endeavors.

The Hale House Center for the Promotion of Human Potential was founded in 1969 as a home for young children born to narcotics-addicted parents. Hale House's goals include the provision of care for these children while their parents undergo rehabilitation, reuniting them with their families and research to understand the long-term effects of addictive drugs on infant growth and development.

This Takes money!

Hale House began as a poverty program sponsored by the Office of Economic Opportunity. It then was redefined as a drug rehabilitation program. Later the City of New York gave us tax levy status. Presently, we are a licensed voluntary child-care agency.

These 15 years of redefinition were necessary because it was felt that children could not be born addicted. We now know that it is possible, and Hale House has seen over 500 recovered infant addicts returned to their parents. During this time Hale House has not been the recipient of major corporate-giving campaigns.

Our supporters, sustainers and, in times of great need, financial saviors, have always been the low to middle income contributors in the community.

We depend on people with low, middle incomes, and they would be the people this proposal would hit the hardest. These small contributions turn into real dollars for the important work we do in caring for children.

The last time we were in Washington was February of this year when President Reagan was kind enough to honor my mother in his State of the Union address. That brought Hale House to national prominence and helped us in our cause.

Concern for the small agency brings us again to Washington to speak before this prestigious committee. We know that government spending must be curtailed and all Americans must make a sacrifice to help you achieve the balanced budget. However, eliminating the tax break for nonitemizers will have two unfortunate effects.

First, it will take away and diminish the incentive to give.

Secondly, it will reduce the free flow of donations to small community agencies like the Hale House.

President Reagan, an honorable man, who has been most vehement in his feeling that government should stay out of the private sector and encourages the citizens to take matters into their own hands. It is a misguided belief that it is fair to continue the deductions of those who give, and who itemize, while cutting the same opportunity that is presently available for those of us who do not have the finances to make really large donations.

I applaud and commend the 30 co-sponsors of S-361 because you realize the great importance of this bill.

According to the Independent Sector report, giving to nonprofit organizations would be reduced by 11 million dollars, or 17 percent in 1986. Eighty-five percent, or 49 billion dollars, of all contributions by individuals come from families with incomes under 50,000 dollars a year.

America is a growing country and we need to help each other. After all, charity begins at home. What we need now is to help the nonprofit agencies who subsist on charitable contributions and provide 32 percent of human services.

Let the man on the street get a tax break on charitable giving the same way as those who earn more than 50,000 dollars a year and find less devastating ways to reduce the deficit.

Many of the unfortunates of this great land need help. The communities can provide this help with some support from the government, and this is an opportunity for the government to share in this human experience.

I know that there are other speakers and the time is brief, and so I thank you on behalf of my mother, the children of Hale House and the small nonprofit agencies of America.

God Bless

The CHAIRMAN. Dr. Clotfelter.

STATEMENT OF DR. CHARLES T. CLOTFELTER, VICE PROVOST FOR ACADEMIC POLICY AND PLANNING, DUKE UNIVERSITY, DURHAM, NC

Dr. CLOTFELTER. Thank you for this opportunity to testify on the effect of tax reform on charitable contributions. I am an economist, and I have spent some time looking at the question of how taxes affect charitable giving. Based on the studies that I have looked at and undertaken, it is my opinion that the kinds of tax proposals being considered today, including the President's proposal, would have a significant impact on charitable giving and reduce contributions by as much as one-fifth.

What I would like to do very briefly is go over some of the economics of charitable giving and then turn to some specific estimates that I have prepared today. There exists, as you know, a large literature on the economics of charity which suggests that taxes have an influence on how much people give.

It is by no means the major reason or the determining reason why people give, but it does influence how much is given. Economic studies separate two kinds of effects. One is an income effect. After your taxes go up, you have less after taxes, and contributions tend to go down. The other effect is a net cost of giving a dollar.

As long as there is a deduction, someone subject to that deduction has a decrease in the tax liability when contributions are given; therefore, the net cost of giving, say, $100 is not a full $100 but something less. For someone in the 50 percent tax bracket, for example, the giving of $100 has a net cost of about $50.

Numerous econometric studies have focused on the magnitude of these effects, and the consensus that has emerged on this net cost effect, which is the most important one when we are talking about revenue neutral proposals, is that a 1-percent increase in the net cost of giving away $1 produces a decrease in giving of more than 1 percent. The ratio between these two percentages is often called a price elasticity, and while there is not precision and certainty about what the precise value of the price elasticity is, especially among lower income taxpayers, there is a great deal of consensus that this is statistically significant and sizable.

In order to assess the likely impact of various tax proposals on charitable giving, I have devised a computer simulation model that incorporates the major provisions of several tax proposals, parameters from economic models, and also economic assumptions to look at what contributions would be under various tax proposals in the year 1985. Like other estimates based on econometric models, these simulations are subject to statistical errors and other kinds of estimation errors and assume that other things remain the same. I also make the assumption that the proposal in question had been in effect for a while because my estimates in other work suggest that it takes a while for taxpayers to adjust their giving behavior.

Table 2 in the written testimony summarizes these predictions using two alternative models. The models predict that contributions under the President's proposal would be on the order of 17 to 18 percent less than under current law. And the major reason for this is the reduced tax rates. Thus, the deduction has less value, and the net cost of giving is higher. There are final points having to do with the President's proposal. One is that the proposal, as you know, includes constructive realization of gifts of appreciated assets in the minimum tax. My estimates do not reflect that one provision. Second, as you know, itemizers are not included in the deduction for the President's plan. I have carried out a simulation to consider what would be the effect of this. If the deduction were extended to nonitemizers under the President's proposal, total contributions would rise somewhere between 7 to 13 percent.

Finally, I could note that other proposals are included in this table and suggest similar kinds of effects. The Treasury I proposal implies a reduction in total giving of 19 to 20 percent; the Kemp-Kasten bill 12 to 15 percent; Bradley-Gephardt about 23 percent; and the DeConcini (Hall-Rabushka) plan, which has no deduction for charitable giving, about a third.

Thank you for this opportunity to testify.

The Chairman. Thank you. I don't want to start questions now, but I want to make sure I understand. I am looking at the table 2 chart. This means the plans we have considered—and we haven't had extensive testimony on the Hall-Rabushka yet—that of the ones that we are considering to date, the Bradley-Gephardt plan is the worst from the standpoint of charitable contributions.

Dr. Clotfelter. Among those listed here, the charitable contributions are lowest.

[The prepared written statement of Dr. Clotfelter follows:]

TESTIMONY

OF

DR. CHARLES T. CLOTFELTER
Vice Provost for Academic Policy & Planning
Duke University

BEFORE THE

SENATE FINANCE COMMITTEE

Washington, D.C.
July 9, 1985

Introduction

I appreciate the opportunity to testify on the impact of recent tax reform proposals on charitable giving. My statement begins with a brief summary of economic studies of the effect of taxes on charitable contributions. Next I describe several tax proposals and a methodology for assessing their effects. I then summarize the simulations and note the shortcomings of this methodology.

How Taxes Affect Individual Giving

Few would argue that taxes are the most important influence on charitable giving. There is considerable evidence, however, to indicate that taxes can have a significant effect on contributions. Economists identify two separate effects. First, taxes obviously affect after-tax income, and the level of after-tax income is highly correlated with the level of contributions. Other things equal, an increase in an individual's tax liability will tend to depress giving by decreasing net income. Second, taxes affect the net cost per dollar of giving. If contributions are deductible in calculating taxes, then making a gift reduces tax liability, and the after-tax cost of giving a dollar becomes less than a dollar. For example, a taxpayer in the 30 percent bracket enjoys a tax reduction of 30 cents for each dollar contributed. The net cost is therefore only 70 cents per dollar of contributions.

Econometric analyses indicate that both net income and the net cost per dollar are significant factors in explaining giving patterns of individuals. Specifically, an increase in net income of 10 percent is associated with increases in giving on the order of seven to eight percent. A 10 percent increase in the net cost per dollar is usually associated with decline in contributions of more than 10 percent, often between 12 and 13 percent. The ratio between these latter percentages changes -- the price elasticity -- may vary over the income scale, and this possibility is reflected in the variable elasticity model. On the assumption that two hypothetical situations differ only by the prevailing tax regime, the effect of changes in tax law can be simulated by applying the changes in net income and net cost per dollar implied by each law.

Current Tax Reform and Effects in Giving

In place of the current tax, current tax proposals would substitute a structure with a broader tax base and fewer deductions, thereby allowing about the same revenue to be raised with lower rates. Whether it uses a smaller number of tax rates or a true "flat-rate" structure, the reduction in tax rates made possible by broadening the tax base has the potential of improving incentives for work, savings, and tax compliance. Table 1 shows the extent of tax rate reduction for several tax proposals.

It is useful to focus on the aspects of tax reform proposals that will have an impact on charitable contributions. In general, tax reform proposals can affect giving in four ways. First, reform proposals can eliminate the deduction or restrict it to taxpayers who itemize their deductions. If no tax credit is substituted, the elimination of the deduction can result in a significant increase in the net cost per dollar of giving. The provisions affecting the deductibility of contributions for each proposal are noted in Table 1. Less obviously, changes that make itemization status less attractive may also affect the number of taxpayers who receive an incentive. Second, any change in the rate of tax will affect the net cost. A reduction in rates -- specifically the rate at which gifts are deducted -- will tend to increase the net cost of giving.

Third, reform proposals may affect the attractiveness of contributing appreciated assets. Currently, a taxpayer who makes a gift of appreciated assets not only receives the benefit of the deduction for the market value but, in addition, does not have to pay the capital gains tax on the contributed property which would have been due if indeed the gain had been realized. This added advantage is eliminated by any proposal that limits the deductible amount to basis or requires capital gains tax to be paid for such gifts. Finally, contributions can be influenced by floors or ceilings that limit the deductibility of contributions.

Before turning to the simulation results, it is useful to summarize the major provisions in the recent proposals made by the Treasury Department and the President that deal with charitable giving. The Treasury's plan had included several provisions that would have had a direct effect on charitable contributions: elimination of the charitable deduction for nonitemizers, imposition of a floor of two percent of AGI for the deductibility of contributions, limitation of the deduction of gifts of appreciated assets to the adjusted basis rather than market value, and the removal of the percentage ceiling on the deductibility of gifts. The Reagan proposal of May 1985 includes only the first of these provisions directly affecting charitable giving. One other provision in the Reagan plan that will affect some taxpayers' incentive to make contributions is the proposed alternative minimum tax. By including in its base as a "preference item" the excess of market value of gifts over basis, it would tend to raise the net cost of giving appreciated assets for some taxpayers. Like the Treasury I proposal of 1984 the Reagan proposal calls for cuts in tax rates, from a maximum of 50 percent in the present law to 35 percent, and other changes that will make it less attractive for taxpayers to itemize their deductions.

Simulation Method

The simulations I report below are based on an econometric model of charitable giving as well as a number of assumptions regarding the growth of income and other economic variables into the future. The methodology employed is described in "Tax Reform and Charitable Giving in 1985" (Tax Notes, February 4, 1985). It is useful, however, to describe some of the features of this simulation method before presenting detailed results. The data which formed the basis of the simulations are published tax return information for 1982. Income and other dollar amounts were "aged" to 1985 using per capita nominal rates of growth of GNP. The resulting income and other dollar quantities at each income level and for each of four types of tax returns were subjected to the definitions and tax rates of the various proposals in order to calculate tax liability and tax rates. Where the proposals called for indexation, such changes are made based on projected rates of inflation. The simulations of tax liability do not account for all aspects of each proposal due to the need for unpublished data. In each case, however, the most important aspects of each proposal are reflected in the simulations as well as all of the major provisions affecting charitable giving directly.[1] Using these proposals, net income and the net cost of contributions per dollar were calculated for four representative households in each of 14 income classes, or 56 representative households per proposal. For each representative unit, the parameters from an econometric model of contributions were applied to contributions in 1982 to project a giving level under the proposal in 1985.

Simulation Estimates

Table 2 presents estimates of total contributions using the two basic econometric models described in the previous paper. As with the previous simulations, the numbers presented here are point estimates subject to statistical and other errors common to econometric simulation in general. The estimates refer to the likely long-run level of contributions that would have been observed if the proposal in question had already been in effect for several years prior to 1985 as has the present law. Finally, these simulations employ an automatic revenue adjustment so that the tax plans considered, with the exception of the

Treasury and Reagan plans, will be revenue-neutral. In general, tax rates are adjusted proportionately so that each proposal will raise the same revenue as actual law in 1985. The Treasury I plan was designed to raise 8.5 percent less revenue than current law and the Reagan proposal 7 percent less, with increases in the corporate income tax making each entire package revenue-neutral.

The estimate of total contributions in 1985 shown in Table 2 is on the order of $60 billion. By comparison, the Giving U.S.A. (1985, p. 7) estimate for contributions by individuals in 1984 is $61.55 billion. Since there is no detailed description of the methodology used by Giving U.S.A., it is impossible to know the reason for this difference, but one possible explanation is that my estimates cover taxpayers only and exclude nonfilers.[2] The second line in the table shows the likely level of contributions under the Reagan 1985 proposal. Using the constant elasticity model, contributions are predicted to be $49.6 billion under the Reagan proposal, compared to $60.4 billion under current law, for a difference of $10.8 billion, or 18 percent in total giving. The variable elasticity model predicts much the same degree of decline, with total giving under the Reagan plan $9.8 billion below the actual 1985 level. While sizable, these predicted declines are smaller than those associated with the Treasury I proposal of 1984, which implied declines of 19 to 20 percent in giving. The 1985 Reagan plan's less severe effect is the result of its restoration of the current favorable treatment of gifts of appreciated assets and its elimination of the two percent floor on the charitable deduction. These estimates do not, however, reflect the impact of the proposed change in the minimum tax.[3]

For comparison, Table 2 also shows the predicted effects of three other widely discussed tax proposals. The Bradley-Gephardt bill, which would allow all taxpayers to deduct contributions at a basic tax rate of 14 percent, would cause giving to fall by about 23 percent in comparison to current levels. The DeConcini bill, based on the Hall-Rabushka plan, has no provision for a charitable deduction; contributions under that plan would be roughly one-third lower than current levels. The Kemp-Kasten bill would, like Bradley-Gephardt, retain the deduction for all taxpayers, though the top tax rate would be cut to 25 percent; contributions would fall on the order of 12 to 15 percent. A final comparison given in Table 2 is a modification of the Reagan 1985 proposal in which nonitemizers are allowed a full charitable deduction. Under this plan, total giving would fall by much less -- on the order of 7 to 11 percent -- than under the actual Reagan proposal. Using the Reagan proposal as a base, the simulations indicate that the addition of a full deduction for nonitemizers would increase total contributions by individuals by 7 to 13 percent.

Caveats

It is important to reemphasize the limitations of the present analysis. There are a number of sources of possible error in these and similar simulation estimates: statistical errors in estimating coefficients used in the econometric models, errors in estimating the proportion of itemizing taxpayers, errors in estimating the contributions by nonitemizers based on 1973 survey data, errors arising from our limited knowledge of gifts of appreciated assets, and forecast errors in the underlying economic variables used, among others. In addition, the tax proposals are not simulated exactly in every detail, although the revenue adjustment tends to mitigate the effect of any errors in calculating tax liabilities. The current data are aggregated, and thus are less appropriate in examining behavior with respect to thresholds such as percentage floors in contribution deductions or preference items. Also, the underlying models used relate to long-run levels of giving, that is, levels that would be reached over a period of years under a given tax regime.

Finally, models such as those used here may fail to reflect fully the range of possible taxpayer reaction to tax changes. One example is the possibility that, faced with a floor for the deductibility of charitable contributions, taxpayers might well choose to "bunch" their giving in alternate years in order to have more of their contribution dollar deducted. The greater this bunching behavior, the less significant would be the effect of a floor. A more important variation in taxpayer behavior would be the possible response of donors to changes in the aggregate level of contributions in the economy. If donors perceived that total contributions were declining and that nonprofit organizations were suffering as a result, a shift in the donations function might occur, implying a greater level of contributions for a given net cost and net income level for an individual. Although some speculation and research has addressed the question of whether public expenditures "crowd out" private giving, there is little hard evidence to go on in assessing the possible impact of a significant decline in overall giving on the contributions of individuals. If the income tax law changes drastically, as envisioned in some of these proposals, it is not inconceivable that charities would redouble their efforts to raise money by pointing out the increased need for gifts. Such effects cannot be readily built into existing models of charitable giving, but they cannot be dismissed as possibilities affecting future giving.

Conclusion

The decline in charitable giving that will likely result from tax reform is only one of a number of important considerations in assessing tax legislation. Such effects obviously must be weighed against other beneficial effects of tax reform, such as increased efficiency and improved equity. Furthermore, evaluation of the benefit of the charitable deduction itself requires more than a simple comparison of induced contributions against foregone tax revenues. The level of charitable contributions remains, however, an important component in a comprehensive evaluation of tax reform.

In comparison to other advanced economies, the United States places great reliance on its nonprofit sector. It has also accorded it comparatively generous tax treatment. For this reason, it is important to be aware of the likely effects of tax reform on a major source of support for the nonprofit sector, contributions from individuals. It bears reemphasizing, however, that the impact on charitable giving is only one legitimate criterion for evaluating tax reform proposals. As long as a deduction for contributions is retained -- as opposed to a tax credit -- the tax rate cuts embodied in most tax reform proposals will tend to depress contributions. This admittedly unintended effect may well be an unavoidable price to be paid for fundamental tax reform.

TABLE 1

Present Law and Selected Tax Proposals: Maximum Tax Rate and Provision for Contributions

Description	Maximum Tax Rate (%)	Provision for Contributions
Current Law	50	Itemized deduction; 50% deduction for nonitemizer
Bradley-Gephardt (H.R. 3271; S. 1421)	30	Deduction (at 14%).*
DeConcini (S. 557) (Hall-Rabushka)	19	None.
Kemp-Kasten (H.R. 5533; S.2600)	25	Deduction.*
Treasury proposal	35	Itemized deduction over 2% AGI; constructive realization of appreciated gifts.
Reagan proposal	35	Itemized deduction; excess of market value over basis included as preference item in minimum tax.

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*Deduction for nonitemizers assumed 50% in 1985.

TABLE 2

Predicted Contributions in 1985 Under Current Law and Various Alternatives

	Constant elasticity model		Variable elasticity model	
	Amount (billions)	Percentage difference from 1985 Law	Amount (billions)	Percentage difference from 1985 Law
1985 Law	$60.4	--	$58.7	--
Reagan 1985	$49.6	-18	$48.9	-17
Treasury I 1984	$48.2	-20	$47.7	-19
Bradley-Gephardt	$46.6	-23	$45.4	-23
DeConcini/Hall-Rabushka	$40.0	-34	$40.9	-30
Kemp-Kasten	$53.1	-12	$50.0	-15
Reagan 1985 plus 100% charitable deduction for nonitemizers	$56.1	- 7	$52.2	-11

FOOTNOTES

1 As described in Clotfelter (1985b), the calculation of taxes and tax rates is designed to reflect the most important features of each proposal without incorporating all changes. In addition, some approximations are used where necessary data are not available. In the case of the Treasury I and Reagan plans, the $5,000 interest ceiling was applied simply to all nonmortage interest, though in fact it is to be applied to interest other than mortgage on the principal residence and interest over investment income. Under the Reagan plan, miscellaneous deductions are added to employee business expenses and made an above-the-line adjustment subject to a one percent floor. I assumed that 75 percent of such expenses, prorated over all taxpayers, would be deductible.

The proportion of taxpayers predicted to itemize for any given income class in the simulation model depends in part on the aggregate ratio of allowable deductions under the proposal in question to deductions under existing law. The estimated value of this ratio under the Reagan proposal was 0.57, compared to a revised ratio of 0.60 under the Treasury I plan. The resulting estimated proportion of taxpayers who choose to itemize is 27 percent under the Reagan proposal, compared to 29 percent under Treasury I and 39 percent under existing law.

2 The GAO (1979, pp. 5, 7) reported that, out of the 68 million taxpayers required to file, over 5 million did not file returns.

[3] For discussion of the impact of the minimum tax provision of the Reagan proposal, see Lindsey (1985).

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SPECIAL REPORT

TAX REFORM AND CONTRIBUTIONS: REPLY TO RUDNEY AND DAVIE

by Charles T. Clotfelter

Charles T. Clotfelter is Professor of Public Policy Studies and Economics and Vice Provost of Academic Policy and Planning at Duke University.

In this article, Professor Clotfelter responds to two articles recently published in Tax Notes which challenged Professor Clotfelter's thesis that current tax reform proposals will reduce charitable giving. In one of the articles, Gabriel Rudney attempted to show that the charitable deduction is an efficient tax subsidy only for high income giving. Tax Notes, January 28, 1985, pp. 367-372. In the other article, Bruce F. Davie argued that high-income taxpayers have not reduced their charitable contributions in response to recent reductions in tax rates. Tax Notes, March 11, 1985, pp. 1037-1040.

Professor Clotfelter contends that the parameters he used "are representative of previous econometric work" and that his model performs reasonably well in predicting actual changes in contributions.

I recently undertook to estimate the likely effect of current tax reform proposals on charitable contributions in the U.S. (Clotfelter 1985b). This work employs parameter values from previously estimated econometric models of giving. Like a number of other analysts who have examined this area, I focus on the impact of tax reform proposals on taxpayers' net income and the price of charitable giving they face.

Two articles recently published in *Tax Notes* have criticized the model I used in my analysis. Rudney (1985) asserts that the price elasticities I used are too large. Davie (1985) argues more generally that models of charitable giving such as the one that I used are not consistent with giving behavior following the 1981 tax cut. Using two alternative models of giving, I estimate that the major tax reform plans would cause contributions to be lower than under current law. The long-run differences in contributions compared to current law, revised slightly since February, are about 19 to 21 percent for the Treasury plan, 12 to 15 percent for the Kemp-Kasten bill, and about 23 percent for the Bradley-Gephardt bill. In this article, I discuss each of these criticisms. Doing so provides an opportunity to consider in more detail the nature and magnitude of the income tax's effect on contributions. I conclude that the parameters I have used are representative of previous econometric work and that the model in fact performs reasonably well in predicting actual changes in contributions.

What is a Reasonable Value for the Price Elasticity of Giving?

The magnitude of the price elasticity of giving is a central element in any simulation of the likely effects of a change in the income tax law on charitable contributions; this is a point that has been made many times by economists studying charitable giving. The point has again been made by Gabriel Rudney, who has criticized simulations by Martin Feldstein, Lester Salamon, myself, and others which use a constant price elasticity. Citing his own work with Gerald Auten, Rudney states: "The implications of the Auten-Rudney replication are that the Feldstein-Clotfelter elasticity of -1.29 is unacceptable, because it is biased by high-income giving experience and that the measured giving impacts . . . using the constant elasticity substantially overstate the negative effects of tax reform proposals on charitable giving." Rudney suggests instead that a set of lower elasticities, based on weighted regressions, be used. Judging from the existing econometric evidence, however, I do not believe there is much to support Rudney's claim that an overall elasticity of -1.3 is "unacceptable."

While there is some evidence that the price elasticity (and income elasticity, to a lesser extent) varies by income level, the econometric evidence is by no means unambiguous on the question. There is probably more evidence to suggest that the price elasticity grows (in absolute value) as income rises, rather than vice versa. For this reason, I have presented simulations based on variable- as well as constant-elasticity models. But the econometric studies in the area still leave considerable uncertainty regarding the price responsiveness of lower income households.

In weighing Rudney's criticism, it is important to consider the results of previous econometric studies, focusing especially on the size of the price elasticity for

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The parameters I have used are representative of previous econometric work and . . . the model . . . performs reasonably well in predicting actual changes in contributions.

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taxpayers at lower income levels. I have recently reviewed the econometric studies pertinent to this point (Clotfelter 1985a). I conclude from that review that (a) if the price elasticity varies, most evidence suggests that it rises in absolute value with income, (b) there is still considerable uncertainty regarding the elasticity at lower incomes, and (c) a single elasticity on the order of -1.3 does not appear to be a bad summary parameter if only one elasticity is used.

The econometric studies in the area still leave considerable uncertainty regarding the price responsiveness of lower income households.

Table 1 summarizes the point estimates from several different studies using different data sets. None of the samples on which these estimates are based were "dominated" by high income taxpayers in the way Rudney characterizes stratified tax files of itemizers at all income levels. The range of price elasticities presented suggests that an elasticity of -1.3 is neither too high nor too low. The median of this group is in fact -1.27, but there is substantial variation in values.

Table 1

Price Elasticities for Samples Not Including or Giving Relatively Little Weight to High-Income Taxpayers

Study	Sample		Estimated Elasticities	
			Price	Income
Feldstein-Taylor (1976)	$ 4,000-20,000	1962[1]	-3.67	0.53
	4,000-20,000	1970[1]	-0.35	0.80
	$20,000-50,000	1962[1]	-0.97	0.61
	20,000-50,000	1970[1]	-0.85	0.89
Feldstein (1975)	$ 4,000-10,000	1948-68[2]	-1.80	0.68
	10,000-20,000	1948-68[2]	-1.04	0.85
Clotfelter-Steuerle (1981)	$ 4,000-10,000	1975[1]	-0.95	0.39
	10,000-20,000	1975[1]	-1.35	0.62
	20,000-50,000	1975[1]	-1.66	0.36
Boskin-Feldstein (1977)	$ 1,000-30,000	1973[3]	-2.54	0.69
Dye (1978)	$ 1,000-50,000	1973[3]	-2.25	0.53
Reece (1979)		1972-73[4]	-1.19	0.88
Clotfelter (1980)	$ 2,000-50,000	1968-70[5]	-1.55	0.70
	2,000-50,000	1970-72[5]	-0.45	0.87
	2,000-50,000	1972-73[5]	-1.34	0.67
Reece-Zieschang (1982)		1972-73[4]	-0.91	1.31
Median			-1.27	68

[1] Treasury Tax Files

[2] Statistics of Income

[3] National Study of Philanthropy

[4] Bureau of Labor Statistics, Consumer Expenditure Study. Primarily low- and middle-income households.

[5] Seven-Year Panel of Taxpayers (random). Long-run estimates.

The summary of my review of econometric studies of charitable giving emphasizes the lack of econometric consensus regarding the variation in price elasticity by income. Because of its relevance to the point raised by Rudney, I quote it here:

> The evidence summarized here provides no firm conclusion regarding the important issue of variation in the price elasticity by income level. The best evidence comes from separately estimated equations, and these estimates strongly suggest that price elasticities at upper incomes are larger than ones in absolute value. Estimates for income groups between $20,000 and $100,000 suggest elasticities around -1, but these estimates are subject to greater variability. For households with incomes below $20,000, the estimates based on the tax returns of itemizers provide variable and imprecise results. These estimates may be compared to those reported [in the chapter on individual contributions] applying largely to low- and middle-income taxpayers: -2.54 (Boskin-Feldstein 1977), -2.25 (Dye 1978), -1.19 (Reece 1979), -1.34 (Clotfelter 1980), and -0.91 (Reece and Zieschang 1982). Ignoring for the moment the difference in estimation techniques used, this set of estimates leaves a very murky picture indeed regarding the price responsiveness of taxpayers at the lower end of the income scale. In choosing which estimates for this group to rely on, one must choose between the precise data of a self-selected group (in studies using tax data for itemizers) or the imprecise data of a randomly-selected group (in surveys), a dilemma that does not apply at income levels where most people are itemizers. (Clotfelter 1985a, Chapter 3.)

In summary, there is little basis for the assertion that a price elasticity on the order of -1.3 overstates average responsiveness because it is based on studies oversampling high-income taxpayers. In fact, studies using a variety of data sets—ranging from random samples of taxpayers to surveys of samples of taxpayers with low incomes—show a range of price elasticities, from the modest to the very large. My simulations employ two sets of elasticity assumptions, one of which has a constant price elasticity of -1.27 and the other of which assumes an elasticity that rises in absolute value with income. For most tax proposals, there is very little difference between these models in estimated impact. I believe that the range and variability of previously estimated price elasticities dictates a cautious approach to simulating the effects of tax reform. Using a representative constant elasticity in addition to a model with variable elasticities is consistent with such an approach.

Are Econometric Models of Giving Consistent With Recent Behavior?

Bruce Davie criticizes my simulations as well as others, including Auten and Rudney, arguing that "recent tax return data are not consistent with the proposition that reductions in marginal tax rates lead to dramatic reductions in charitable giving, particularly among upper-income groups." He selects income classes and years around 1975 and in 1983 to yield approximately the same number of high-income taxpayers in both years. He then finds that average contributions for this group increased in real terms over the period despite a decline in the marginal tax rates facing those taxpayers. He concludes from this that the economic model of giving is inconsistent with observed behavior.

To ask how a model performs in predicting actual outcomes is certainly fair, but Davie has applied an unduly simplistic test of the model which leads to a mistaken conclusion. To show this requires somewhat more attention to the properties and assumptions of the economic model of giving than Davie gives. The response is therefore almost as long as his article.

It is useful to begin by considering a simple constant-elasticity model of giving:

$$(1) \quad G = AY^a P^b X^c e^v ,$$

where G is contributions, Y is net income, P is the price of giving, X is a set of other factors influencing contributions (such as attitudes, age, family composition, factors that influence the perceived need of charitable organizations and other non-tax factors), v is an error term, and A, a, b, and c are constants. The model can be used to predict giving in any period 2 based on giving in a base period 1 and changes in explanatory variables from one period to the next:

$$(2) \quad G_2 = G_1 (Y_2/Y_1)^a (P_2/P_1)^b (X_2/X_1)^c$$

This formulation makes it clear that the predicted change in contributions depends on more than just the change in the price of giving. In relation to the Davie criticism of this model, it is useful to make three points.

1. **Increases in average contributions, even in the wake of tax rate cuts, are not necessarily inconsistent with the economic model of contributions.** Although the price of giving for high income taxpayers did increase as a result of the 1981 rate cuts, incomes after taxes also increased markedly. For the high income group of about 38,000 taxpayers cited by Davie, after-tax income increased by 86 percent in constant dollars. Average contributions in constant dollars rose by only 23 percent. The relevant question is, Why was the percentage increase in giving so much less than the increase in income? One obvious explanation is the increase in price of giving over the period, but the prediction of giving in 1983 clearly involves more than a simple focus on the price effect.

2. **Available data for 1975 and 1983 are insufficient to provide a precise prediction of giving for 1983.** There are four sources of uncertainty in making a prediction for 1983 for the purpose of testing the model's usefulness. First, any prediction based on parameters estimated by regression analysis is subject to a definable statistical error. (See Clotfelter 1985a, Chapter 3.) Though usually not large in relation to point estimates, such errors are one reason why simulation estimates are properly interpreted as approximations. Second, factors other than price and income could have changed over the period 1975 to 1983. For this reason, it is preferable to compare years as close together as possible in order to minimize the influence of other such effects. Third, as Davie suggests, adjusted gross income may not be an appropriate measure of income. Davie argues that the portion of realized capital gains in AGI ought to be excluded from income, but it is equally arguable that *all* realized gains ought to be included, not just the 40 percent in AGI.

Finally, the lack of information on the gain-to-value ratio of gifts of appreciated assets makes it impossible to measure the price change exactly.[3] As Davie notes, 1983 was a much better year for capital gains than 1975, with capital gains increasing as a proportion of AGI. Using the New York Stock Exchange composite index, stock prices were at the same nominal level in 1975 as they were in 1970. By contrast, stock prices increased by 72 percent in the five years preceding 1983. Consistent with that is the observation that the proportion of contributions made in cash by this high-income group declined from 52 percent in 1975 to 42 percent in 1983. Analogously, it is quite likely that the ratio of gains to basis for gifts of assets increased over the period. There are no data on this ratio, however.

Accounting for the average effect of the maximum tax on earned income that was in effect in 1975, the marginal tax rate for the top 38,000 group identified by Davie was 0.636 in 1975 and 0.5 in 1983.[4] If one accounts for the proportion of gifts made in cash in each year, as noted above, incorporates assumptions regarding gain-to-value ratios, and assumes there were no other changes between 1975 and 1983 affecting giving, it is possible to calculate predicted giving in 1983 for this group. If, for example, one assumes the average gain-to-value ratio remained unchanged at 0.5 over the period, the price and income parameters yield a predicted decline in real giving of about six percent. Given the actual increase of 23 percent in average contributions, this set of assumptions clearly yields an underestimate. If, however, as seems more likely, the gain-to-value ratio increased for asset gifts by this class, the predicted increase is much closer. Assuming an increase in this ratio of 0.25 to 0.75 between the two years implies a predicted increase of 20 percent. It should be emphasized, though, that even this calculation makes the dubious assumption that no variables other than price and income changed between 1975 and 1983.

3. **The economic model of giving performs reasonably well in predicting the impact of the 1981 tax cut on contributions.** In order to provide a more useful test of the model of giving, it is important to look at more than one income class as well as to pick years that are closer together. For this purpose I selected the years before and after the 1981 tax rate cut, 1980 and 1983. The years 1981 and 1982 were excluded because of the likelihood that individuals in upper income classes sought to accelerate their giving in 1981 in order to take advantage of the higher rate of deductibility in that year. Davie objects to such a comparison because inflation erodes the constant dollar value of income class limits, causing the real in-

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[3] Because a taxpayer making a gift of appreciated assets avoids capital gains tax in addition to receiving the deduction, the ratio of gain to value affects the price. The expression for the price is given in footnote 2 of Table 2.

[4] The marginal tax rate in 1975 for the over-$200,000 class in 1975 was calculated by taking a weighted average of marginal tax rates applying to the average taxable income ($289,201), based on rates of 0.64 for joint returns and 0.70 for nonjoint returns. The resulting average of 0.648 was then adjusted for the effect of the maximum tax on earned income using the equation $m = m^* - (m_e - .50)\,q$, where m^* and m_e are marginal tax rates on total and earned taxable income without the provision and q is the proportion of AGI that is "earned" income, as defined by the provision. The resulting rate was 0.636.

This method, in combination with the adjustment for gifts of appreciated property, was also employed in calculating the prices for 1980.

come level in a class to decline over time. Because the economic model accounts for changes in real net income, however, I am not convinced that there is any great problem in making such a comparison.

Table 2 presents average contributions by income class in 1980 and 1983 along with percentage changes in net income, price, and predicted and actual average contributions. Because of the closeness in the years being compared, a constant 50 percent gain-to-value ratio was assumed and predicted contributions were adjusted to account for the likely incomplete adjustment in giving behavior between 1981 to 1983.

A comparison of the last two columns shows that the model (again, ignoring other influences), while not predicting changes precisely, does provide a useful set of predictions regarding the pattern of changes. Contributions for the three top income classes are predicted to fall the most, and fall the most they do. The predicted values tend to underestimate giving at lower incomes, and this could well indicate the influence of other, nontax effects. For the top four income classes together, the model predicts a decline in average contributions of 15 percent; the actual decline was 14 percent.

To summarize this section, Davie's contention that post-1981 giving behavior is inconsistent with existing econometric models does not hold up upon careful examination, unless "consistency" is taken to mean "precision." No responsible analyst would suggest that such models will produce exact predictions, even when nontax factors are included. Simulations such as those I have reported on make the "all other things equal" assumption. As I have stressed elsewhere, the point estimates produced are subject not only to deviations from this assumption but also to statistical error and to errors in underlying economic assumptions. Given these standard caveats, however, the model of charitable giving that I and others have used for simulation appears to have performed well. Not only are the parameter values representative of a large number of separate econometric studies, but the model is successful in predicting the single most important effect of the 1981 tax cut on charitable giving: the decline in average giving in the highest income classes.

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Table 2
Actual vs. Predicted Changes in Contributions
Between 1980 and 1983

Income	Average contributions in 1980 dollars		Percentage change in:			
	1980 actual	1983 actual	Net income[1]	Price[2]	Predicted contributions[3]	Actual contributions
Under $5,000	173	144	-10	0	- 5	-17
$5,000 under $10,000	436	437	-11	+ 1	- 6	0
$10,000 under $15,000	513	560	-11	+ 4	- 8	+ 9
$15,000 under $20,000	523	589	-11	+ 3	- 7	+13
$20,000 under $25,000	565	581	- 6	+ 1	- 4	+ 3
$25,000 under $30,000	624	638	-16	+ 3	-10	+ 2
$30,000 under $50,000	854	808	-13	+ 3	- 8	- 6
$50,000 under $100,000	1,725	1,504	-13	+ 8	-12	-13
$100,000 under $200,000	4,988	4,142	- 4	+38	-23	-11
$200,000 under $500,000	13,898	10,570	- 4	+53	-29	-23
$500,000 under $1,000,000	47,433	29,242	- 2	+57	-30	-38
$1,000,000 and over	207,089	110,001	+ 4	+83	-36	-47

[1] Net income = AGI - taxes after credits.

[2] Price = C(1-m) + (1-C)(1-m-0.5mc), where C = proportion of contributions in cash, m = marginal tax rate, and mc = marginal tax rate on capital gains income. The marginal tax rate for 1980 is adjusted for the effect of the maximum tax on earned income. See Clotfelter and Salamon (1982). 1982 values of price were used for 1983 because complete data for 1983 were not available.

[3] The model used was $G^*_{t+1} = G_{t+1} (Y_{t+1}/Y_t)^{[illegible]} (P_{t+1}/P_t)^{[illegible]}$ and $G_{t+1} = (G^*_{t+1})^{[illegible]} (G_t)^{[illegible]}$, where G is actual contributions, G* is the long-run level of contributions, Y is net income, and P is price.

Source: U.S. Internal Revenue Service, *Statistics of Income—1980, Individual Income Tax Returns*, and Hostetter and Holik (1985).

The CHAIRMAN. Thank you. Ms. Rowland.

STATEMENT OF JULIET C. ROWLAND, VICE CHAIRMAN, UNITED WAY OF PENNSYLVANIA, AND DEPUTY DIRECTOR, URBAN LEAGUE OF HARRISBURG, PA

Ms. ROWLAND. Thank you very much, Senator. I want to add my voice to the chorus of thank you's to you, Senator Moynihan, Senator Durenberger, and Senator Grassley.

Senator DURENBERGER. Would you repeat the part about Moynihan? [Laughter.]

Ms. ROWLAND. Thank you for your past support of charitable contributions. I am not an expert. I am a volunteer of almost 20 years in my community. I have been an active volunteer in the United Way movement for 12 years and am currently serving as vice chairman of the United Way of Pennsylvania and I am professionally the deputy director of the Urban League of Harrisburg. The 90 United Ways in Pennsylvania have raised well over $130 million in 1984, an 8.2 percent increase over 1983. Even with the persistent Pennsylvania unemployment problems, we expect to do as well in 1985. However, repeal of the incentives provided by the charitable deductions for nonitemizers, as President Reagan recommends, will mean a projected $10 million loss, a virtual cancellation of our projected increase. Such a substantial loss will cause hurt everywhere in our State but especially in the communities where heavy industry has been the traditional mainstay of the economy. Reduction in Federal funding followed by severe cutbacks in the steel and related smokestack industries serve to exacerbate need while eroding the support on which United Ways in communities such as Pittsburgh, Johnstown, Bethlehem, Beaver Falls, and others depend. Many of those people who gave generously in the past are now in critical need of United Way help. Initially reeling under the onslaught, United Ways have through hard and creative fundraising campaigns been able to continue funding those services in our communities that are critical.

If United Ways are to continue to effectively respond to reduced Government funding and the realities of a changing economy, we will need every fund-raising tool available to help increase giving. Maintaining tax incentives for all working Pennsylvanians is critical to our fund-raising efforts. Thus, retention of the charitable deduction for nonitemizers is a key factor in ensuring that United Ways will have this continued capacity to respond to the new and ever-changing needs of the people we serve. Increased public support for simplifying a complicated Tax Code is both understandable and welcome. Most United Way volunteers, like other Americans, certainly support streamlining our tax laws. All proposals now being discussed, including Treasury's, increase the standard deduction and personal exemption to benefit the lower income taxpayer. Poverty level workers would be exempt from Federal income taxes. These are positive steps. However, these beneficial changes increase the number of persons who do not itemize their deductions and, therefore, would have an unintended adverse impact on charities. Estimates are that Treasury's proposals would increase nonitemizers to as high as 80 percent of our taxpayers. Treasury further calls for the repeal of the charitable deduction for nonitemizers. The result would be a charitable deduction for only the wealthiest one-fifth of our taxpayers. Charities are concerned over losing the needed broad community support for their endeavors. Keeping in mind that the goal is not only to increase funds to be gained by nonitemizing taxpayers, but their participation as well. A giver is a volunteer. Volunteers from every income level are essential to the operational viability of most charities. A further concern is that, if a charitable deduction were available to only a few, it would be viewed just like another tax break, and this has not been the case since the charitable deductions inception in 1917. Gifts to help others have never been viewed as a part of income to be taxed. As you know, nonprofit organizations constitute a vital part of the Nation's service delivery system. We collectively provide a significant amount of the health care, family services, civic action, cultural life, research, higher education, and social services provided in this country. And we serve as the principal conduit for channeling private charitable contributions into the solution of community problems. With Government retrenching at the Federal and the State and local levels and expectations for private nonprofit initiative continuing to grow, charitable organizations will be in constant need of new sources of funding. United Ways believe that repeal of the nonitemizer deduction is a mistake. We believe that the Senate should encourage—not discourage—charitable donations and that all Americans should receive incentives to participate, and we believe the way to accomplish this goal is to include the provision of the bill S. 361, supported by my Senator John Heinz and others on your committee, to make the nonitemizer charitable deduction permanent in your tax simplification bill. Again, I want to reiterate that I am not an expert. I am a volunteer who has served in the United Way, watching my United Way in Harrisburg provide a variety of services to diverse populations. And we would encourage you to continue those incentives. I would like to, once again, thank you, Senator Packwood, for the opportunity to speak to you today.

The CHAIRMAN. Ms. Rowland, you would be amazed how often anecdotal experience of volunteers is infinitely more helpful than the testimony of experts. You did very well and I appreciate it.

Ms. ROWLAND. Thank you.

[The prepared statement of Ms. Rowland follows:]

STATEMENT OF
JULIET ROWLAND
VICE CHAIRMAN, UNITED WAY OF PENNSYLVANIA
IMMEDIATE PAST PRESIDENT TRI-COUNTY UNITED WAY
DEPUTY DIRECTOR, URBAN LEAGUE OF METROPOLITAN HARRISBURG
BEFORE THE
SENATE FINANCE COMMITTEE

JULY 9, 1985

Mr. Chairman, I am Juliet Rowland, Vice Chairman of the United Way of Pennsylvania and the immediate past president of the United Way of Harrisburg, Pennsylvania. I have been actively involved as a volunteer with the United Way for twelve years. Professionally, I am the deputy director of the Urban League of Metropolitan Harrisburg.

The ninety United Ways in Pennsylvania have raised over $130 million in 1984, an 8.2% increase over 1983. Even with the persistent Pennsylvania unemployment problems, we expect to do as well in 1985. However, repeal of the incentives provided by the charitable deduction for nonitemizers, as President Reagan recommends, will mean a projected $10 million loss -- a virtual cancellation of our projected increase.

Such a substantial loss will cause hurt everywhere in the state, but especially in our communities where heavy industry has been the traditional mainstay of the economy. Reduction in federal funding followed by severe cutbacks in the steel and related smokestack industries serve to exacerbate need while eroding the support on which United Ways in communities such as Pittsburgh, Bethlehem, Johnstown and Beaver depend. Many of those people who gave generously in the past are now in critical need of United Way help.

Initially, reeling under the onslaught, United Ways, through hard and creative fund raising campaigns, have been able to continue funding many of the services that have been critical in our communities. If United Ways are to continue to effectively respond to reduced government funding and the realities of a changing economy, we will need every fund-raising tool to increase giving. Maintaining tax incentives for all working Pennsylvanians is critical to our fund-raising efforts. Thus, retention of the charitable deduction for nonitemizers is a key factor in insuring that United Ways will have the continued capacity to respond to the new and changing needs of the people we serve.

Increased public support for simplifying our complicated tax code is understandable and welcome. Most United Way volunteers like other Americans support streamlining our tax laws. All proposals now being discussed, including the U.S. Treasury Department's, increase the standard deduction and personal exemption to the benefit of lower income taxpayers. Poverty level workers would be exempt from federal income taxes. These are positive steps.

However, these beneficial changes increase the number of persons who do not itemize their deductions, and, therefore, would have an unintended adverse impact on charities. Estimates are that the Treasury's proposals would increase nonitemizers to as high as 80% of the taxpayers. Treasury further calls for repeal of the charitable deduction for nonitemizers. The result would be a charitable deduction for only the wealthiest one-fifth of taxpayers.

Charities are concerned over losing the needed broad community support for their endeavors. The goal is not only the increased funds to be gained from the nonitemizing taxpayers but their participation as well. A giver is a volunteer. Volunteers from every income level are essential for the operational viability of most charities. A further concern is that if the charitable deduction were available only to the few, it would be viewed like any other tax break, this has not been the case since the charitable deduction's inception in 1917. Gifts to help others have never been viewed as a part of income to be taxed.

Nonprofit organizations constitute a vital part of the nation's service delivery system. We collectively provide a significant amount of the health care, family services, civic action, cultural life, research, higher education and social services provided in this country. We serve as the principal conduit for channeling private charitable resources into the solution of community problems. With government retrenching at the federal, state and local levels and expectations for private nonprofit initiative continuing to grow, charitable organizations will be in constant need of new sources of funding. The permanent charitable contributions law would provide a dependable source of new funds on a permanent basis.

In the 1981 tax bill, nonitemizers were allowed a deduction for their charitable contributions on a phased-in basis. In 1986, nonitemizers will be able to deduct all of their gifts. It is estimated that this provision will increase charitable giving as much as $6 billion annually. More importantly, it will surely bring a flow of new voluntary effort so vital to United Way agencies that provide for the homeless, recreation, social services, and other health and human service needs. Similar results will flow to the rest of the voluntary sector whose activities so enhance our daily lives.

United Ways believe repeal of the nonitemizer deduction is a mistake. We believe that the Senate should encourage, not discourage charitable donations and that all Americans should receive incentives to participate. The way to accomplish this goal is to include the provision of the bill supported by my Senator, John Heinz, and others on your committee (S. 361) to make the nonitemizer charitable deduction permanent in your tax simplification bill.

Thank you, Senator Packwood, for the opportunity to speak to you today.

Senator **Durenberger**. Mr. Chairman, first I would like to thank you for holding this hearing. And in mentioning S. 361, I am reminded that a couple of years ago, when the two of you right there in the middle of the table took the lead on the above-the-line charitable deduction I was looking at some higher tax reform or trying to accomplish some larger good at the same time. I was the 11th person, as I recall, to vote for the above-the-line deduction. And I don't want to get trapped in that same situation again this year. While I am for comprehensive tax reform, I am also signing on as a cosponsor of S. 361 today and hope that more of the people on this committee will do so. But I wanted just a minute to introduce Kenneth Keller. He is the product of education at the University of Minnesota by being a leader on its faculty for 21 years. He is now a member of the faculty of the school of engineering and was the chairman of that school. He was also the dean of the college of liberal arts, and by dint of a lot of hard work and by an interesting process, became president of the University of Minnesota. This year, he took up a great challenge. We have one thing I notice, clearly, in common. To weeks ago when all of our offices were being occupied by Nicaragua protesters, the very next day the same 100 people that occupied my office ended up in his office on the issue of South Africa. But he is from the school of hard knocks, as are all these educators, and he is here today representing the American Council on Education.

The **Chairman**. He is representing an awful lot of things this morning, as best I can tell from the opening page of his statement.

The **Chairman**. Dr. Keller.

STATEMENT OF DR. KENNETH H. KELLER, PRESIDENT, UNIVERSITY OF MINNESOTA, MINNEAPOLIS, MN

Dr. **Keller**. Thank you very much, Senator Durenberger. I appreciate that introduction. I am also a native of New York State, so I guess I have relations to more than one person on the panel. I am appearing here today as a representative of the American Council on Education and as president of the University of Minnesota. And I don't want to repeat what has been said well by some of the other members of this panel, but I do want to point out that when we talk about the charitable contribution, we are not simply talking about the interest of private universities and colleges or private institutions. In fact, of the $5.5 billion of charitable giving to institutions of higher education, over 30 percent of it has gone to public institutions, and in fact, the University of Minnesota last year received over $47 million in support from private giving and 40 percent of that came from individuals. That, to put it in perspective, was over 10 percent of our operating budget for instruction and research. So, the importance of private giving to public institutions is equal to that of private giving to private institutions, and that is one of the reasons why I am particularly pleased to be here and to thank those of you who have played such an important role in seeing that we can keep the incentives for that kind of charitable giving. I think tax reform is important. Good tax reform involves a balance. We trade lower tax rates in a simplified form against the exclusion of certain kinds of special privileges and special treatments. And that makes some sense. But for those of us who are recipients of private giving, those of us in educational institutions, the balances are not as clear. Right now, it looks as if many of the proposals represent things we are giving and not necessarily things we are getting. There has been mention of the marginal tax rate, and, of course, the reduction of the marginal tax rate is an important part of tax reform. But we do pay a price for that in giving, as Dr. Clotfelter has pointed out. The issues of State and local tax deductibility, of tax exempt bond treatment, the general reductions in Federal support that are necessary to deal with the deficit are all things which will impact negatively on us. Thus fairness—balance, if you want—suggests that the charitable contribution at least has to be protected. If we are to promote the public-private partnership, we have to promote the private part of it. And for that reason, we are very happy to see the changes from the original Treasury proposal which will ensure that charitable contributions are at least protected to a certain degree. I would like to comment on three elements which we think still need to be changed and for which we would encourage your help. One is the treatment of appreciated property in the minimum tax proposal. The idea of including appreciated property in the calculation of minimum tax, I believe, is not appropriate. I believe that it is not necessary, and I believe that ultimately it is unwise. I think it is not appropriate because the minimum tax is intended to protect us against excessive tax shelters. Charitable giving is not a tax shelter. Charitable giving is just that. It is giving away something which you own and which you don't have after that. It helps the institutions that get it. It isn't a necessary part of the minimum tax assessment. A very, very small number of individuals would be affected by the inclusion of the appreciated property in the minimum tax calculation. On the other hand, it is very unwise because those few people constitute a very important part of the givers to public and to private colleges and universities. Over half of the gifts in excess of $5,000 that come into universities are in the form of appreciated property. It is a very important point. Let me quickly add two other points that I think need to be made about the treatment of charitable deductions. The administration's proposal presently recognizes the importance of charitable gifts to institutions, but one of the major uses of those gifts is the support of scholarships and fellowships, which are not luxury items, which are keeping people in school. Those, under the proposal, will be taxed to the extent that they exceed tuition. In effect, we have recognized the importance of charitable gifts on the one side, but we have introduced a provision which will make them less effective on the other side—that is, we will tax them. That is an unnecessary thing to do because if students earn money for services rendered, they will be taxed under the present law. The idea of taxing these gifts—these scholarships and fellowships—goes beyond that, and I think that ought not to be the case. I lend my support and thank my Senator for his endorsement of the above-the-line contribution deduction. That is an extremely important thing to us. Thirty percent of our givers make less than $30,000 a year, and I must say that developing the habit of giving is what we are trying to do. And if I can sum up briefly in 30 seconds, Mr. Chairman, let me say that I think we are faced here with tax reform which is intended to be revenue neutral. If, in addition, it produces a reduction in private giving, then the net is going to be a loss to institutions which is going to reduce their effectiveness, and I don't think that is good public policy. Thank you, sir.

[The prepared written statement of Dr. Keller follows:]

STATEMENT OF

KENNETH H. KELLER

PRESIDENT

THE UNIVERSITY OF MINNESOTA

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

JULY 9, 1985

ON BEHALF OF

American Association of Colleges of Nursing
American Association of Community and Junior Colleges
American Association of State Colleges and Universities
American Council on Education
American Society for Engineering Education
Association of American Medical Colleges
Association of American Universities
Association of Catholic Colleges and Universities
Association of Jesuit Colleges and Universities
Association of Presbyterian Colleges and Universities
Association of Urban Universities
Council of Independent Colleges
Council of Graduate Schools in the United States
National Association for Equal Opportunity in Higher Education
National Association of College and University Business Officers
National Association of Independent Colleges and Universities
National Association of Schools and Colleges of the United Methodist Church
National Association of State Universities and Land-Grant Colleges

Mr. Chairman and Members of the Committee:

I am Kenneth H. Keller, President of the University of Minnesota. I appear before you today on behalf of the American Council on Education, an association representing over 1,500 colleges, universities, and other organizations involved in higher education, and the associations listed on the cover sheet of my statement. There are many aspects of the tax reform legislation now being considered by this Committee that are of deep interest to the higher education community, but among the most important of them are the proposed changes related to the treatment of charitable contributions, the focus of today's hearing.

In 1983-84 colleges and universities received over $5.5 billion in voluntary support. Although most people appreciate how much private institutions depend on such gifts, the extent to which public institutions also depend on this kind of support is less well known. In fact, during 1983-84, donations to public institutions constituted over 30 percent of total charitable giving to higher education. At the University of Minnesota we received during that year over $47 million in gifts, or about 10 percent of our instructional and research budget. Increasingly, the health of institutions of higher learning, public as well as private, depends on these voluntary donations. Therefore, we believe that any proposed changes in the tax treatment of charitable contributions should be carefully analyzed for their effects on this vital support for the nation's colleges and universities.

To understand the great concern that this issue has generated, one needs to consider the context in which these particular changes are being proposed. The Administration's tax reform plan is intended to provide certain balances. Individuals and corporations would receive the benefit of significant reductions in tax rates in exchange for a repeal or modification of a variety of deductions, credits, and other special provisions. All of these changes taken together would be revenue neutral and, of course, the simplification of the tax form itself would be a benefit. However, tax-exempt organizations, including colleges and universities, cannot benefit from reduced rates or from simplified tax forms. For them, there are only costs and, in many instances, very great costs. Consider the following:

- The decrease in marginal rates would increase the costs of giving and thereby reduce the level of giving. Nationally recognized economists have estimated donations are likely to drop by several hundred million dollars as a result of this factor alone.
- The removal of state and local tax deductibility is likely to decrease public support of higher education from local sources.
- Restrictions on the uses of tax-exempt bonds could remove another source of support for colleges and universities, particularly with respect to student loan programs.
- All of these changes would occur at a time in which Federal budget cuts that affect education are being proposed to help us deal with the national deficit.

I understand and appreciate that the concerns of the higher education community on these and other issues, such as taxation of fringe benefits and tax incentives for campus-based research, will be heard at a later date. However, the advent of some or all of these changes makes it especially important that the provisions in the tax code dealing with charitable contributions be protected and preserved.

With regard to charitable giving, we are pleased by the changes in the original Treasury Department proposal made by the Administration, specifically the preservation of the fair market value deduction for contributions of property and the elimination of the floor on deductibility. We thank the members of this Committee who helped bring to the Adminisration's attention the concerns of the charitable community with respect to these proposals. It appears, however, that other modifications to the current proposal will be necessary if we are to maintain private, voluntary support of higher edcuation. Let me mention three of them briefly.

Treatment of Unrealized Appreciation as a Preference Item

We believe that the Administration's proposed inclusion of the unrealized appreciation in charitable contributions of property in calculating the minimum tax is inappropriate, unnecessary, and unwise. It is inappropriate because the purpose of that tax is to ensure that no individual totally shelters his or her income from taxes. But charitable contributions have never been thought of as a tax shelter. We do not believe that it is appropriate to include contributions of property in the effort to address the use of tax shelters. In addition, under current law there is a separate limitation on the percentage of income that an individual can deduct for charitable contributions of property, and this limitation ensures that taxpayers cannot totally escape taxation through gifts to charities.

It is unnecessary because it will have a very minimal effect on tax collections. Preliminary simulations of the effects of the proposed revision indicate that 79,600 taxpayers with adjusted gross income in excess of $100,000 would pay minimum tax under the Administration's plan in 1986 - only 5 percent of the roughly 1.5 million taypayers in that income class. If charitable contributions of property were deleted from the list of preference items, the minimum tax would still apply to 93 percent of this group.

It is unwise because, while it would have a small effect on tax collections, it would have a significant effect on large gifts to colleges and universities. The 5 percent of taxpayers who fall in the minimum tax group account for 65 percent of the value of all contributions of appreciated property by individuals in their income class. Moreover, it is estimated that appreciated property comprises more than half of the gifts in excess of $5,000 to higher education.

For minimum taxpayers, inclusion of the appreciation element of contributed property in the tax base for the minimum tax calculation can, under cetain circumstances (when coupled with other changes proposed by the Administration), result in a cost of charitable giving that is not only higher than under current law, but actually higher than under the original Treasury proposal to tax all unrealized appreciation in gifts of property. This would be devastating for the kind of large gifts upon which many institutions of higher education depend.

Taxation of Scholarships and Fellowships

One of the major purposes for which gifts to colleges and universities are used is for scholarship and fellowship grants. These grants are not luxuries, but a vital factor in allowing undergraduates to stay in school and to finish their degrees. They are equally important in encouraging first-rate graduates to forgo the much higher earnings that would otherwise be available to them to pursue advanced studies.

The current tax proposals recognize the importance of these awards by treating gifts used by colleges and universities to provide scholarhips and fellowships as deductible charitable contributions. However, the Administration proposes to tax the students receiving the grants to the extent that the grants are not expended by degree candidates for tuition and necessary equipment. Thus, support for room and board and other living expenses would be taxed, even though the student may be living below the poverty level and, particularly at the graduate level, has incurred significant opportunity costs to stay in school.

The tax policy justification for this change is far from clear. Present law already imposes a tax on amounts received by students that represent compensation for performing services, such as teaching. To go beyond this limits the effectiveness of the charitable gifts that other sections of the Administration's proposal seek to encourage. We do not believe that this would serve the public good.

Repeal of Deduction for Non-Itemizers

Although others will speak to it in more detail, this statement would be incomplete without at least a brief mention of the importance of continuing the charitable contribution deduction for individuals who do not itemize deductions. It is through the contributions of these individuals that colleges and universities develop the patterns of giving that become a lifetime habit and are therefore a key to the spirit of voluntarism in our nation.

Conclusion

In summary, our concern is that the steps taken in the public interest to simplify and reform our tax code not work against the public interest in and need for higher education. If total tax revenue remains constant and private giving to colleges and universities decreases substantially, the total dollars available to higher education will decrease. This will result in either a diminution in the quality and diversity of higher education or the need to shift a greater fraction of public funds to its support. The latter course would deprive us of private partnership in the effort and would actually be less cost-effective. We believe this would also be inconsistent with the intention of both the Administration and the Congress, and we urge you to preserve the elements of the charitable deduction treatment that will avoid this outcome.

STATEMENT TO

COMMITTEE ON FINANCE

UNITED STATES SENATE

July 9, 1985

ON BEHALF OF:

American Association of Colleges of Nursing
American Association of Community and Junior Colleges
American Association of State Colleges and Universities
American Council on Education
American Society for Engineering Education
Association of American Medical Colleges
Association of American Universities
Association of Catholic Colleges and Universities
Association of Jesuit Colleges and Universities
Association of Presbyterian Colleges and Universities
Association of Urban Universities
Council of Independent Colleges
Council of Graduate Schools in the United States
National Association for Equal Opportunity in Higher Education
National Association of College and University Business Officers
National Association of Independent Colleges and Universities
National Association of Schools and Colleges
of the United Methodist Church
National Association of State Universities and
Land-Grant Colleges

On behalf of the American Council on Education, an association representing over 1500 colleges, universities and other organizations involved in higher education, and the associations listed on the cover sheet of this document, we are pleased to submit this statement on the tax reform proposals being considered by the Senate Finance Committee. Our members have an interest in this tax reform legislation that is immediate and vital. In that respect we are no different from any of the associations and organizations that are offering testimony and presenting arguments concerning the President's tax proposals. In two critical respects, however, our position on tax reform is quite different, and I believe that our specific positions can only fairly be evaluated in light of those differences.

The Administration's tax reform proposal offers both to individuals and to corporations the benefit of significant reductions in tax rates, in exchange for which a variety of deductions, credits and other special provisions are to be repealed or modified. The President has called upon the American public and American business to accept the loss of special purpose provisions in the interest of financing rate reductions, and has challenged taxpayer groups to support the reform effort on that basis, without seeking narrowly focused exceptions and exclusions.

The American Council on Education recognizes that genuine reform is desirable to maintain public confidence in the Federal income tax system, and we therefore support in principle the Administration's tax reform package - but in so doing we are all too well aware that the higher education community will not benefit directly and, in fact, will be substantially and uniquely disadvantaged as a result of a reduction in tax rates.

Professor Lawrence Lindsey of Harvard University estimates that the Administration's plan would reduce giving to nonprofit organizations by $11 billion, or 17 percent, in 1986. Of this amount, about $5.37 billion is attributable to the reduced incentive to give resulting from a reduction in marginal tax rates. When we consider the provisions of the Administration's package relating specifically to higher education, therefore, we cannot proceed, as almost all other groups can, on the assumption that we are paying a price in the loss of advantageous provisions in exchange for substantial benefits through rate reduction. Instead, we anticipate the loss of billions of dollars in charitable support occasioned by the reduction in marginal rates, at a time of Federal budget cuts and of increased needs for student aid and other forms of support. In view of this situation, it is especially critical that other provisions in the tax code important to higher education be protected and preserved.

The second factor that distinguishes the higher education community is that the interests it represents are not private interests but public interests. Colleges and universities exist to serve the public through teaching, research and direct community service. We believe that the public need for higher education is at least as compelling as the public need for tax reform, and I am confident that the Congress does not intend to sacrifice one public good for another. In fact, the changes made in the original Treasury proposal by the Administration with respect to the charitable contribution deduction reflect a recognition that charitable giving is an essential resource for all colleges and universities, and that any significant decline in contributions would diminish the quality and diversity of higher education, at the expense of us all. This Administration has sought to encourage the private sector to do more and government less. A policy resulting in significant reductions in contributions to higher education does not serve this objective.

We are pleased by the changes made by the Administration, specifically the preservation of the fair market value deduction for contributions of property and the elimination of the floor on deductibility. We believe, however, that substantial problems for higher education remain in the President's tax proposals.

Treatment of Unrealized Appreciation as a Preference Item

During consideration of the Treasury plan, a good deal of concern was focused upon the proposal to tax unrealized appreciation in charitable contributions of property. Although the Administration rejected this approach, it has proposed that the unrealized appreciation element of contributions be treated as a tax preference item for purposes of the alternative minimum tax.

We believe that inclusion of charitable contributions in calculating the minimum tax is inappropriate and unwise. The purpose of that tax, which we support, is to assure that no individual totally shelters his or her income from taxes, and particularly to limit the benefits available from special incentive provisions that may not be sound as a matter of tax policy but that for political or other reasons cannot be eliminated from the Internal Revenue Code. Indeed, in the volume containing the Administration's proposals the changes in the minimum tax are included in the chapter titled "Curtail Tax Shelters". Charitable contributions have never been thought of as a tax shelter, and we do not believe that it is appropriate to include these contributions in a regime designed to tax special interest deductions through a back door in the taxing system.

The Administration's proposal regarding the minimum tax is not only unsound in theory, but damaging in practice. We believe that the reversal of the Treasury's original proposal to tax the appreciation element of contributions reflected the President's recognition of the importance of charitable gifts of property. It has been estimated that over half of all gifts in excess of $5,000 to higher education are in the form of securities, real estate, or other appreciated property. For large gifts, however, the Administration's proposal may actually be a greater disincentive than the Treasury plan. Given the importance to our society of encouraging charitable gifts, it would be unwise to discourage giving among those able to contribute large amounts.

The minimum tax affects a relatively small number of individuals. Simulations of the effects of the proposed revisions by Professor Lindsey indicate that 79,600 taxpayers with adjusted gross income in excess of $100,000 would pay minimum tax under the Administration's plan in 1986 - only 5 percent of the roughly 1.5 million taxpayers in that income class. These individuals, however, are projected to account for approximately 65 percent of the value of all contributions of appreciated property within their income group.

For these minimum tax payers, inclusion of the appreciation element of contributed property in the tax base for the minimum tax calculation will (when coupled with other changes proposed by the Administration) result in a cost of charitable giving that is not only higher than under current law, but actually higher than under the Treasury plan. This change would be devastating for the kind of large gifts which many institutions of higher education depend upon. As colleges and universities seek to increase the portion of support that they receive from the private sector, it is essential that there be adequate incentives for giving for those who have the capacity to make truly exceptional gifts. With charitable contributions deleted from the list of preference items, the minimum tax would still apply to 93% of those who would be covered by the Administration's proposal. Treatment of contributions as a tax preference item is thus not critical to the effectiveness of the minimum tax - but it could be critical indeed to college and university fund-raising efforts.

We are convinced that while this effect of the Administration's proposal may have been unintended, it is extremely serious, and it is of great concern to those who serve and those who support the cause of higher education.

Repeal of Deduction for Non-Itemizers.

The President's tax proposals include the repeal of the charitable contribution deduction for individuals who do not itemize deductions. The analysis presented in support of this change asserts that contributions by non-itemizers are not affected significantly by tax considerations and that any adverse effect of the repeal on charitable giving will be slight. To the contrary, studies show that the financial and other effects of loss of the non-itemizer deduction would be very substantial. If the Administration's tax package is enacted, some 20 million taxpayers, more than half of all taxpayers with incomes between $30,000 and $50,000, who today itemize their deductions would become non-itemizers. Currently 85% of all charitable contributions by individuals come from families with incomes of under $50,000 a year. Independent Sector estimates that the loss of the non-itemizer deduction would reduce contributions to nonprofit organizations by some $6.7 billion in 1986. It is simply wrong to suggest that such a loss would not be significant.

Apart from the immediate financial cost, there are other concerns associated with the loss of the non-itemizer deduction. Colleges and universities are very sensitive to the need to encourage a pattern of giving by small contributors, who are often recent graduates. Younger alumni and alumnae contributors are almost certain to be non-itemizers. Without a deduction incentive they are unlikely to develop an early pattern of giving, which could expand the base of charitable giving through increased support at a later time. The 1985 Annual Report of Giving USA shows that while 1984 giving to all charities increased by 11.6%, giving by alumni and alumnae was up only 5%. If the financial problems of young college and university graduates brought about by increased borrowing to pay for their schooling are compounded by the loss of the non-itemizer incentive to give, we may be jeopardizing a long tradition of alumni and alumnae support.

With the elimination of the non-itemizer deduction, only one in four or five taxpayers would be able to deduct contributions. The Administration's proposal would thus seem to suggest that charitable giving can - or should - be left only to those with larger incomes. But the genius of American society from the beginning has derived in part from an assumption that a great many people, from all income classes and with a full range of moral, aesthetic and intellectual values, will support a broad array of charitable, religious and educational organizations of their choice. If we were to eliminate the incentives for private giving for such purposes and substitute direct federal grants, even in equivalent amounts, we would be immeasurably poorer as a nation.

Even in a radically reformed tax structure, the charitable contribution deduction should remain in place. If it is narrowed or undercut, the loss will be felt not only in the decline of financial support for charities, but in a decline in the underlying spirit of voluntarism and in the cultural richness and diversity of our society.

Repeal of Deduction for State and Local Taxes

The Administration's proposal to eliminate the deduction for state and local taxes is one of the most controversial elements in the reform package, and the effects of such a change would be manifold. The effects on higher education are not among those most commonly mentioned, but they are substantial.

Economic analyses indicate that repeal of the deduction could lead to a decline in state and local tax revenues of between 7 and 15 percent. This reduction will have to be matched by a comparable reduction in services and expenditures, or by an increase in state and local tax rates. State and local governments together allocate about 36% of their general expenditures to education, with higher education getting over a quarter of this amount. State governments alone spend 38% of their budgets on education, with a third going to higher education. Higher education appropriations by state and local governments totaled over $44 billion in 1983. The American Association of State Colleges and Universities projects a yearly decline in state support for higher education of between one and two billion constant dollars if deductibility is eliminated.

Community and junior colleges and state colleges and universities are largely dependent upon state governments to meet operating costs. However, all parts of the higher education community would be affected to some extent by the reduction in state and local budgets which would result from the loss of deductibility of state and local taxes. This decline in state and local government support for higher education would come just at the time when many states have begun to reinvest in higher education after a long period of reduced support, and at a time when the Federal share in education is declining. The President's New Federalism should encourage rather than discourage the assumption by states of responsibility for the welfare of their citizens. The proposed tax policy is inconsistent with this goal.

Restrictions on Use of Tax Exempt Bonds

The Administration proposes to tax interest on obligations issued by a state or local government if more than one percent of the proceeds is used by a non-governmental person, including a tax-exempt charitable or educational entity. This would cause the virtual elimination of access to the tax-exempt market for private non-profit educational institutions, while placing substantial restrictions on the availability of tax-exempt bonds to public higher education. Although restrictions on tax-exempt financing for private purposes may be quite appropriate, we believe that the Administration's proposal to allow tax exemption for governmental activities while denying it for activities of a tax-exempt educational entity that serves identical public purposes is arbitrary and misdirected. The creation of distinctions between private and public institutions in such a critical area would be contrary to a long tradition of diversity and equal treatment in higher education.

Numerous states utilize tax-exempt financing to ensure access to loans for the nation's college students. It is hard to imagine a more public purpose than the provision of low interest loans to fill the gap which often exists in available capital for needy students. Yet the Administration's proposal would prohibit states from using some of their tax-exempt allocation to develop student loan programs - thereby limiting a state's ability to invest in the intellectual development of its citizens. Tax-exempt financing currently provides states with a mechanism for the provision of non-Federally guaranteed supplemental loans and offers an additional source of financing for Guaranteed Student Loans (GSLs). We urge continued availability of this important source of financing so that college students can be assured of access to funds to finance their college costs.

Colleges and universities also utilize the proceeds of tax-exempt bonds to construct or renovate academic buildings, dormitories and libraries; to renovate electrical and fire detection systems; to redesign facilities for better access for the handicapped; to develop energy management and conservation systems; to construct and renovate student health facilities; to purchase equipment for research; and for a variety of analogous purposes. Access to tax-exempt financing is critical to academic health centers building clinical teaching facilities that demand capital in amounts that universities cannot secure in the general market.

Colleges and universities use tax-exempt bonds for the traditional kinds of public purpose activities that the Internal Revenue Code requires as a precondition to tax-exempt status under section 501(c)(3). In fact, one rationale for the tax-exempt status of private non-profit institutions is precisely that they serve purposes and carry burdens that the government would otherwise bear. The Administration asserts in its proposal that "the issuer of non-governmental bonds would not spend its own revenues to support the activities that are federally subsidized through tax-exempt non-governmental bonds." Colleges and universities, however, facing serious budget constraints, would be unable rather than unwilling to finance the costs of loans and facilities, and would thus be unable in this critical respect to fulfill their exempt function of lessening the burden of government.

The Administration's proposal indicates that $95 billion of long term tax-exempt bonds were issued in 1983, and that 61% or $58 billion of that total were "non-governmental" bonds. In that same year, tax-exempt higher education facilities financings accounted for less than 3% of all long term tax-exempt issues. The volume of section 501(c)(3) bonds is thus relatively insubstantial, and the effect of removing such bonds from the crowded capital markets would pass almost unnoticed.

While the budget impact will be slight, the effect on private higher education of the loss of access to tax-exempt financing will be dramatic. Using current interest rates, withdrawal of tax-exempt capital would increase institutional costs for a twenty year borrowing by 34 percent for fixed rate debt, and by 51 percent for variable rate debt. These added costs would ultimately be passed on to students, their families, and others (including the Federal government) who assist in meeting the direct cost of attending post-secondary institutions or purchasing their services.

Taxation of Scholarships and Fellowships

The Administration proposes to include scholarship and fellowship grants in gross income, except to the extent that grants are spent for tuition and equipment. Students would thus be taxed for 1986 and subsequent years on scholarship funds used to meet room and board and other living expenses. The tax policy justification for this change is far from clear, especially since present law already imposes a tax on amounts that represent compensation for teaching or other services that students perform in exchange for stipends. The Administration's tax package retains many of the provisions of present law that depart from pure tax theory, and that are defensible only on grounds of non-tax social or national policy. Even if it were clear that scholarships and fellowships should be subject to tax in a pure tax system, it is difficult to justify taxation in a system that includes incentives or forebearances designed to encourage certain behavior.

The revenue effect of this proposed change would not be at all significant - yet the impact on students, especially those with limited personal resources, could be dramatic. Under the Administration's proposal, tax is imposed on income in excess of $4,900 for a single person, and it is imposed at a marginal tax rate of 15% (a rate that under present law applies only when taxable income exceeds $7,010). The poverty threshold for a single person is $5,800. For a poor student, the taxation of a scholarship or fellowship grant may therefore result in real deprivation, at a time when there are many other pressures combining to make it difficult to continue a course of study. At the graduate level this proposal may increase the difficulty of encouraging first-rate students to incur the costs and forego the earnings necessary to pursue advanced studies. Yet, what can be more important to our society than encouraging our most talented students to become the scholars, teachers and leaders of succeeding generations?

Nondiscrimination Rules for Fringe Benefits

The Administration proposes a uniform nondiscrimination rule for all fringe benefits. This rule would replace the nondiscrimination provisions of the Tax Reform Act of 1984, under which fringe benefit plans would be tested for discrimination on the basis of eligibility or availability. The Administration's proposal would substitute a utilization test, based on the percentages of employees actually receiving benefits under a plan, and a dollar cost comparison test, based on the dollar amount of benefits actually used by employees. These tests would inevitably prevent a great many employees from qualifying for the exclusion for tuition reduction benefits, which are frequently the most significant and sensible fringe benefits a college or university can offer.

Although a utilization test may be appropriate for those fringe benefits that employees of all ages can use, it is clearly unsuitable for tuition reduction plans. When offered by a college or university, tuition reduction benefits by definition go to employees with college-age children. These older and more experienced employees invariably tend to be more highly compensated. As a result, under a utilization test a tuition reduction plan will inevitably be found to be discriminatory, since college tuition reductions do not and cannot benefit younger employees with younger children. A utilization test thus would defeat the purpose of the tuition reduction exclusion, and should not be applied to tuition reduction benefits.

The proposed dollar cost comparison test for nondiscrimination would be equally inappropriate for many of the same reasons. Tuition reductions will inevitably tend to benefit the more senior, more highly compensated employees. Moreover, many tuition reduction programs provide only a percentage of tuition and costs. In choosing colleges for their children, employees must take into account their own ability to pay the remaining expense, with the result that children of lower compensated employees may tend to select lower priced schools. Even assuming that similar percentages of highly compensated and lower compensated employees actually used tuition reduction benefits, a dollar cost comparison test is likely to result in a finding of discrimination. Furthermore, under both tests, a plan may be nondiscriminatory in one year and discriminatory in another, simply by reason of the accident of children's college selections. An employee cannot realistically be expected to make financial plans for educating his or her children when the employee's tax liability will depend on the happenstance of other children's college selections.

We do not believe that any real consideration was given to college tuition reduction plans in the decision to shift to a utilization standard in testing for discrimination. The eligibility standard of the 1984 Act, with which colleges and universities are even now struggling to comply, is a reasonable and effective standard for these plans and should be preserved.

Incentive for Campus Research

The President's tax proposal includes a three year extension of the research and experimentation credit, along with a revision of the definition of qualified research to target activities likely to result in technological innovation. In the analysis section the proposal notes that other legislative issues "such as a credit for contributions to fund basic university research or an enhanced charitable deduction for contributions of scientific equipment to universities, are typically associated with the research credit". The Administration took no specific position on these very important issues.

In both houses of Congress legislation has been introduced that would provide a 20 percent, nonincremental credit for corporate expenditures on basic research carried out by qualified institutions, along with an enhanced deduction for corporate donations of instructional equipment, previously used equipment, and computer software. The credit for basic research is a minimal incentive for the kind of highly creative intellectual effort that colleges and universities are uniquely able to foster and serve. The enhanced contribution deduction would be a significant step in reversing the deterioration of the research and training capacity of colleges and universities.

Provisions such as those now found in S. 58 and H.R. 1188, to which the Administration's proposal alludes, will encourage cooperative efforts between universities and industry, resulting in the transfer to companies of basic research findings that can be converted into new and innovative products and services that will preserve the competitive position of American companies in the world market.

We are disappointed that the Administration did not specifically endorse these proposals in its package. We are confident, however, that the Congress understands the need for basic research and training capacity, and that the research incentives now reflected in S. 58 and H.R. 1188 will be included in the reform bill.

Employee Educational Assistance

We applaud the Administration's support earlier this year of legislation to make permanent the Employee Educational Assistance Act (section 127 of the Internal Revenue Code), and we believe that such a provision should be made part of the tax reform package. The Employee Educational Assistance Act was enacted in 1978 to provide for certain tax-free educational assistance paid by employers for their employees. Without congressional action, this piece of legislation, which benefits both employees and colleges and universities, will expire at the end of this year.

Since 1978, section 127 has offered a substantial incentive for employers to provide educational and training programs, that has been used increasingly by corporations throughout the country. Lower level employees particularly have been encouraged to seek specialized education necessary for job advancement, and employers have been encouraged to promote the training and increase the technological sophistication of their work forces. The provision contains adequate safeguards that prevent discrimination in favor of officers, shareholders, and highly compensated employees, and that prohibit abuse in the form of frivolous courses relating to sports or hobbies. Permanent enactment would permit employees and employers to continue making use of the valuable opportunities that this program has afforded. Legislation on this issue should also clarify permanently the tax status of tuition support given to graduate teaching and research assistants at colleges and universities.

The cost of section 127 is relatively slight, but the return to both employers and society is substantial. Our national needs for employment, retraining, technological advances, and opportunities for the traditionally underemployed are so great that it seems shortsighted to eliminate a program that in a few years has achieved significant, demonstrable success.

Faculty Housing

The Administration's proposal did not address an issue that the Congress and the higher education community have been discussing for several years. The Internal Revenue Service has taken the position for audit purposes that educational institutions that rent housing to faculty at cost rather than at a full commercial rate must treat the theoretical foregone profit element as compensation, that faculty members must include in income and with respect to which the institution must pay employment taxes. The Congress last year adopted a moratorium on Treasury action in this area, but the moratorium is due to expire at the end of 1985.

The issue of faculty housing is insignificant in its revenue implications, but it is extremely important for a number of institutions that have traditionally looked to faculty housing programs to provide the anchor for an educational community that promotes and enhances real intellectual exchange between faculty and students. Colleges and universities are not seeking a way to provide free housing in lieu of compensation. Faculty housing programs typically involve substantial rents, covering all costs of providing the housing. The problem has arisen from the arbitrary and artificial position urged by the Internal Revenue Service, under which non-profit educational institutions are treated essentially as commercial landlords, with no objective but the maximization of profits. This approach is shortsighted, impractical to administer (requiring actual appraisals of each housing unit each year), and faulty in its legal analysis. We believe that this is an appropriate occasion for a permanent legislative solution to this problem, in the form of an exclusion from income of the value of faculty housing provided at cost by educational institutions.

Conclusion

The Administration's tax reform proposal would drastically undermine the long established national policy of encouraging voluntary gifts to organizations serving essential public purposes. In addition, the proposal would have a dramatic impact on the financial resources of a large number of colleges and universities, and would deprive many of the margin of excellence which they seek to attain. At a time when government spending is under increasing scrutiny, it is essential that the tax code provide an environment conducive to the fostering of voluntary support of those institutions in our society that promote and sustain the Nation's interests.

The CHAIRMAN. Thank you. Dr. Murnane.

STATEMENT OF DR. THOMAS W. MURNANE, SENIOR VICE PRESIDENT, TUFTS UNIVERSITY, MEDFORD, MA

Dr. MURNANE. Thank you, Mr. Chairman. Obviously, I am the last of the presenters, and so I will try not to repeat the very good points they have made in the last 20 minutes. I am a senior vice president for a university in the northeast, Tufts University, and I have been involved in the last few years in a development effort to try and bring about improvements to our university, similar to improvements being brought about in many universities across the United States. There are some 3,000 universities and colleges out there, and over the past 20 to 50 years, they have become extraordinarily dependent upon the support of their alumni, good friends, corporations, and foundations. These people have become investors in the functioning of a university. The universities are important to all of us in that they are the future of America. They are part of us in terms of liberal arts education, engineering, medicine, dentistry, veterinary medicine, and these are all dependent upon the interest of the American citizen in making sure they excel in the future. Several items in the proposed legislation have direct impact on what we are trying to do as educators—the appreciated portion of property donations, the alternative minimum tax, the removal of the above-the-line deduction for nonitemizers, and the private purpose bond situation will have a direct impact, if they are approved on how we operate in the future. The bottom line of that whole thing will be that tuitions will increase, programs will be reduced, and the facilities will be reduced. Finally, I would just like to urge you to give serious consideration to all of the presentations given here today, and I hope that you will be able to bring about what we all want. Thank you.

The CHAIRMAN. Thank you.

[The prepared written statement of Dr. Murnane follows:]

United States Senate

Committee on Finance

Testimony by

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July 9, 1985

Mr. Chairman and members of the Committee, it is a pleasure to appear before this Committee to testify on the important issue of charitable giving and tax reform. I am here as Senior Vice President of Tufts University, and speak as well for Dr. Jean Mayer, President of Tufts University and Chairman of the New England Board of Higher Education.

The need for fairness and simplicity in the tax code has been emphasized over and over again. Fairness and simplicity are important, but in the tax bill as presented the Administration clearly accepts the fact that they are less crucial than making sure our society works. Some societal goals have to be supported, for example, the special treatment for the oil and gas industry written into the bill to insure energy independence. The activities of most charitable organizations are in this category. Indeed, given budgetary constraints and the federal deficit, there is no other avenue of support. If the tax proposal goes through as it stands, the indications are that it will hurt most charitable institutions, and perhaps kill some. In the long run our society would not work as well. Our competitive positon in the world would be weakened.

For the purposes of the income tax, the words "charitable organization" cover a wide range of nonprofit, philanthropic institutions. They are not only community organizations like the United Way or United Fund, but also medical and health groups like the American Heart Association, the American Cancer Society, and the March of Dimes, and smaller groups like the National Braille Press and the Lupus Foundation.

They are public radio and television, libraries, museums, associations committed to protecting children, animals, or the environment, to providing shelter for battered women, legal help for the poor, special care for the handicapped and the elderly, and improving safety in the work place. They are hospitals and research institutes, as well as educational institutions, from prekindergarten to graduate schools of business, law, the health sciences,and engineering.

Americans have held charitable activities in high regard for quite some time. Alexis de Toqueville, in Democracy in America, noted that voluntary associations and activities were far more imporatant in the United States than in France and England. So it is not surprising that our dependence on the private sector to fund public purposes was embodied very early in the federal tax code, in the War Revenue Act of 1917, and that the charitable exemption has been in force ever since.

Unlike other deductions, the charitable deduction does not put more money into the hands of the person who deducts it from his tax. It goes to support these "special interests," which are certainly not "special" in the pejorative sense. They are the public's interests. They truly promote the general welfare. In other industrialized nations, a number of the activities listed are state, that is, national, responsibilities. They are paid for or subsidized by the central goverment. At a time when the federal government is increasingly asking that the states, corporations, and private individuals assume greater responsibility for these public purposes, we should not use tax reform to narrow the base on which volunteerism rests.

The analyses of the President's proposal are just coming in. However, overall, the preliminary figures for 1986 show that charitable giving would be reduced by some 17 percent, from a projected $66.3 billion under the curent law to $55.3 billion. It has been said that Americans are the most generous people on earth and that giving will continue whatever the tax system permits in deductions. But how much people can give is affected by the amount they have to give and the cost of giving it.

As the proposal stands, and indeed this is true of all the tax proposals, different types of institutions would be affected very differently because of the different distribution of their contributors. It is probably true that certain types of giving would be relatively unaffected by taxes: for example, plate collections in churches and the practice of tithing in some religions. By contrast, we know well from experience in fund raising in universities that most large donors take the tax impact of charitable giving into considerable account.

In his analysis of the effects of charitable giving under Treasury I, Professor Charles T. Clotfelter of Duke University found that giving to higher education, which depends very heavily upon high-income donors, would decline by 27 percent. Tufts University has just completed a $145 million fund-raising campaign. In our case, this could have represented a drop of some $39 million. Whether it could have come from gifts for endowment, operating funds, or the construction and renovation of teaching and research facilities cannot be determined. But this reduction in any case could have added to the pressure on tuition.

Private institutions are particularly dependent upon fund raising; public universities have other sources of support. The United States faces increasingly successful competition not only from other industrialized nations but also from basic industries that are being set up in some developing coutries. There is a real danger to the nation if it is made more difficult for some of its best universities, most particularly our research universities, to raise money.

A number of provisions in the proposed bill would have an impact, direct or indirect, on higher education; for example, the final disposition of the rate for long-term capital gains, the credit for research and development and equipment donations, the rules on fringe benefits, particularly health benefits and pensions. Tuition benefits for their children are particularly important to some faculty members, who are sacrificing much higher salaries in industry to teach future engineers and computer scientists. Any changes in the law which affect the ability of parents to put aside funds for children's education or the price or availability of scholarships, fellowships, and student loans is of concern to universities. We could live with a number of these changes. Others are far more serious.

The most devastating is the treatment of appreciated properties given to charitable institutions. Here, again, the effect will be felt most strongly by private universities. In the United States, institutions of higher education have three main sources of support: tuition, which we must keep under control; state or federal grants — mostly state for public colleges and universities, and federal for private institutions; and contributions from individuals, foundations, or corporations. Tuition must go for current operating expenses. State and federal grants are given for specific teaching and research programs. We depend heavily upon private support, and particularly upon large donations, for funds to endow chairs in new fields, create scholarships, begin innovative programs of teaching and research, support graduate students, build or renovate facilities for classrooms and laboratories, and most particularly add to the endowment that will let us do more of this in the future. These gifts are vital not only in themselves, but also as leadership gifts in capital fund drives.

Just as an illustration, in Tufts University's last fund drive, which ended this February, two percent of the donors gave 80 percent of the money. Somewhat more revealing is the fact that some 22,000 individuals participated in the five-year effort. Our goal of $140 million was surpassed by $5 million. We were able to add $26 million to the endowment, for scholarships, financial aid, faculty and program support. Forty-two million dollars of the total was in smaller donations, principally from alumni, in the form of operating support. Seventy-seven million enabled us to add or update teaching and research facilities. We now have six new endowed chairs in vital areas ranging from international security studies to pediatric medicine.

Historically, some 40 percent of individual gifts to institutions of higher education are in the form of appreciated property. More than 60 percent of the gifts for capital purposes are in this form.

Twenty-five percent of the capital gifts to Tufts' campaign came from friends of the University - not alumni or parents, but people outside the university who have a deep interest in what Tufts is doing and what we are trying to achieve in innovative teaching, research, and service to our community, the nation, and the world. For these people, the cost of giving is a large consideration. Economic studies have shown that making gifts of appreciated properties fully deductible is a cost-effective way of supporting charitable purposes; that, for each dollar gained by the government in tax revenue, the charity would lose somewhere between $1.19 and $1.49 — the figure most generally agreed upon is about $1.24.

The provision in Treasury I which limited deductibility of appreciated property to the lesser of the current market value or the indexed basis of the property has been removed from the President's proposal. But sadly, the situation appears to be worse. The appreciated portion of these gifts has been included in the list of preferences subject to the alternative minimum tax. Preliminary estimates by Professor Lawrence Lindsey of Harvard University and the National Bureau of Economic Research show that some 79,000 taxpayers with incomes over $100,000 face the minimum tax in 1986. That is about five percent of the total 1.5 million in this income class. However, these people are estimated to give about $2.96 billion of the total $4.57 billion of appreciated property of all taxpayers with over $100,000 in adjusted gross income. Thus, some 65 percent of all giving of appreciated property will be done by people subject to the alternative minimum tax. The average price of giving for high bracket taxpayers rises about five percent over Treasury I.

The studies also show that excluding appreciated property from the calculation for the alternative minimum tax would still mean that about 74,200 taxpayers would be subject to the tax. It would preserve 93 percent of its effectiveness without this provision.

Also of great concern to private colleges and universities is the change in tax exemption of state and municipal bonds when used for private purposes. While public institutions would still have access to these low-interest bonds, private institutions would not. Using these bonds, we have been able to proceed with the construction of vital research or teaching facilities or student housing before the full amount of pledged gifts was in hand. If this provision remains in the bill, our costs will rise and progress will slow.

Another large concern, shared by public institutions, is the loss of itemizing status and of above-the-line charitable deductions for non-itemizers. This would have a severe effect on a number of charities. The percentage of non-itemizers would rise from 59.5 under the current law to 76 percent under the President's proposal, with an estimated loss in gifts of some $6.8 billion in 1986. Many of these contributions are in comparatively small amounts, but they add up. This kind of gift is important to educational institutions in "annual fund" appeals. For example, in the past five years, Tufts alumni and parents gave some $18 million in such gifts. To eliminate their ability to deduct these gifts is to say to them, "Only those wealthy enough to itemize and claim the charitable deduction need to be concerned about giving." Young people who might well become large donors later on are told, in effect, that their contributions do not count, and are discouraged from forming the habit of giving. Public institutions are beginning to seek out these gifts. Further, some 31 percent of all charitable giving to higher education now goes to the public sector. Institutions like the University of Maryland, the University of California (particularly at Berkeley) and the University of Texas have been major beneficiaries of large gifts and legacies.

The loss of deductibility of state and local taxes may pose increasing problems for education at all levels. The American Association of State Colleges and Universities has pointed out that all states are affected, and that a modest overall estimate would be a one-to-two billion constant dollar yearly decline in state support for higher education alone if deductibility were eliminated.

It has been pointed out that the rules for establishing a charitable foundation make it possible for some questionable goals to exist. It seems appropiate to look at a tighter definition of what constitutes a foundation or other legitimate charitable activities. But it is essential that all Americans have the incentive to continue to support crucial charitable activities. There is absolutely no replacement for the pursuit of these national goals other than through the voluntary organizations.

America's position in the world rests less on our military power than on the educated brains of our people and our historic reputation as a just, caring, and effective society. The charitable institutions more than pay their way in direct and indirect contributions. With the help of state and local government and the generosity of individuals, foundations, and corporations they are trying to do more.

A new tax system should not deliberately undermine that effort.

The **Chairman**. Dr. Clotfelter, are there studies around which would attempt to prove that there is no reduction in charitable giving even if the tax rates drop?

Dr. **Clotfelter**. There have been some studies in recent months to suggest that, one, the responsiveness used in most models is too high, and another study that I know of that suggested that actual changes in contributions are not consistent with the models that underlie my model and others.

The **Chairman**. Who has done those studies?

Dr. **Clotfelter**. One was not a study. It was more of an "op-ed" piece, and the other was a study by a staff member of the Ways and Means Committee, Bruce Davie, who looked at changes in actual giving and focused on high income individuals. And I will be happy to give you 2 minutes on it if you want.

The **Chairman**. Yes, go ahead.

Dr. **Clotfelter**. The question he raised is a fair one. We had a decrease in the tax rates in the 1981 tax cut—at the top from 70 to 50 percent. If one believes the econometric models that I and others have used, that would imply an increase in the net cost of giving, especially for upper income individuals. And so, the debate that he wanted to generate there centered on the question of whether one actually saw a decline. As Brian O'Connell mentioned, the average gifts at high incomes have, in fact, decreased. And what I did in response to that was to go back and use the model to see what would have been predicted by the model between 1980 and 1983—the years which spanned that tax cut and are not affected by any anticipatory giving. For individuals over $100,000, the models predicted a decline of average giving of 14 percent, and the actual decline in average giving was 15 percent. The model does not predict perfectly, and it underestimates giving in some income classes, but I think that it is a fair representation of what we have seen.

The **Chairman**. Did the Ways and Means staff member study approve the other? I mean, did they contend that giving did not go down in those income classes? What study did you cite where I said is there evidence to the contrary? And did you say a Ways and Means staff committee member?

Dr. **Clotfelter**. The one I mentioned—the Bruce Davie study—appeared in Tax Notes in March, something like that.

The **Chairman**. And did that study say simply that giving did not go down at those incomes? I mean, is it contradictory to the facts that yours and other studies show?

Dr. **Clotfelter**. What I argued there—and I don't want to go into detail; I would be happy to insert for the record my response—was a response to a simple and somewhat simplistic kind of statement. It required going into detail much more than is polite to talk about in public. One needed to go into gory details of econometrics, and I would be happy to insert that, but basically what I answered was to say that the net cost went up and contributions did not go down concomitantly ignores the fact that after-tax income for upper income individuals, due to the 1981 Tax Act, really increased dramatically. And models such as the ones I have used take into account the fact that it is not only the net cost of giving a dollar but it is also the after-tax income that affects giving. And there is also the fact that there are other things that are affecting charitable giving which models such as this really cannot cope with. So, one must take them as approximations to some extent.

The **Chairman**. Let me ask Mr. O'Connell and the others this then. Assuming that Dr. Clotfelter is right—and I think he is—that is, as the tax rates go down, the inducement to at least give larger amounts is reduced—I believe that was your premise—that while the Tax Code may not actually encourage you to give once, it may encourage you to give a larger amount if you give. Does that put you in a position of opposing falling tax rates as being adverse to charitable contributions?

Mr. **O'Connell**. No, Mr. Chairman. We would be in a pretty silly posture to be arguing for higher tax rates simply because they have an impact on the size of gifts. I said we are willing to choke down that part of the loss relating to decreased rates if, in your wisdom, you do decrease rates. But we are saying that, given that unintended impact on giving, for goodness sake, don't compound that loss by the other provisions, such as the repeal of the Charitable Contributions Law.

The **Chairman**. It seems to me that makes that all the more critical, and you know, maybe not for the bad if we indeed can get millions and millions and millions of people to give $50 or $100 or $200 or $300 and reach the same or greater total than a fewer number giving greater amounts. That probably is to the net good in terms of their commitment and volunteer activity, in addition to giving. But clearly, if we are going to discourage giving at the top, we should not at the same time discourage giving at the bottom also.

Mr. **O'Connell**. I would hope we wouldn't discourage giving at all. As you two know, and certainly Senator Durenberger——

The **Chairman**. Of course, the inevitable result of the lowering of the tax rate is to discourage giving, and maybe that is the inevitable result.

Mr. **O'Connell**. My own guess is that in the long run the larger motivations will overcome even that loss, but it will take a long time. The larger motivations are the things that generate this kind of society, and to the extent that Government can encourage it, that is terribly important.

The **Chairman**. Senator Moynihan.

Senator **Moynihan**. Thank you, Mr. Chairman. I find it very reassuring to hear some real econometrics, economic science and personal experience being brought to bear. And we welcome Senator Durenberger's addition to what are now 32 sponsors of S. 361. I would like to welcome my fellow New Yorkers, Dr. Hale and Mother Hale, and just for the record, be clear about one thing. The work at Hale House is primarily involved with the care of children who are born with a certain drug addition acquired *in utero*. Is that not the case, Dr. Hale?

Dr. **Hale**. Yes, that is true.

Senator **Moynihan**. And generally, this is heroin addiction, is it not?

Dr. **Hale**. When we started in 1969, it was heroin. More recently, it has been a combination—polydrug use. We find children born addicted to heroin, methadone, cocaine, and alcohol.

Senator **MOYNIHAN**. It would be fair to say—and I am asking an obvious question—that heroin and cocaine are smuggled illegally into the United States against the laws of the Federal Government; are they not?

Dr. **HALE**. Yes, they are.

Senator **MOYNIHAN**. And if the Federal Government were enforcing the laws, there would be very much less work to do at Hale House. Is that not right? I mean, if we eliminate heroin pushers and cocaine pushers, we would reduce the problem greatly. You do your work because the Federal Government fails to do its work. You have to raise money to make up for the damage done to children.

Dr. **HALE**. Yes, we certainly do. We certainly have to raise money.

Senator **MOYNIHAN**. And I know 122d Street where Hale House is located. Just a block away on the avenue is a curbside drug exchange.

Dr. **HALE**. Absolutely.

Senator **MOYNIHAN**. Where you can buy drugs, and the only Federal people in that curb exchange are people from the Drug Enforcement Administration who are recording price information.

Dr. **HALE**. Yes.

Senator **MOYNIHAN**. This is dead serious, as Dr. Hale is saying.

Dr. **HALE**. Yes. That is right. And we are certainly aware that we are talking about an underground economy that is in excess of $150 billion a year.

Senator **MOYNIHAN**. And all you do is try to get people to give you $10 and $20 to help the innocent victims of this plague.

Dr. **HALE**. That is what we ask for. We usually get $2 or $3.

Senator **MOYNIHAN**. $2 or $3?

Dr. **HALE**. $2 or $3 is what we get. After my mother was introduced to the Nation by President Reagan, we continued to get $2 or $3, but we have traveled extensively throughout the country to talk with people about the problem of children born addicted to drugs. And of course, with the last problem, children born addicted to drugs that also have AIDS. And so, that has complicated the problem of drug abuse.

Senator **MOYNIHAN**. Could I then ask the panel this question? Is it not a common experience that small donations matter a great deal to institutions, not just because of the amounts of moneys collected—there are, after all, more poor people than there are rich people—but also because you get volunteers that way. Is that not the experience? Can I just go down the line of witnesses? Mother Hale?

Mrs. **HALE**. That is right.

Senator **MOYNIHAN**. That is right? Dr. Hale?

Dr. **HALE**. Oh, yes.

Senator **MOYNIHAN**. Ms. Rowland?

Ms. **ROWLAND**. Yes. Absolutely. The average United Way giver in my community, for example, gives about $2 to $5 per pay period.

Senator **MOYNIHAN**. All right. We heard $2 to $3 over here. We heard $2 to $5. We are talking about small sums in a country where they can add up to large amounts.

Mrs. **Hale**. If I may add something, we get $2, $1, and very often they come in an envelope in cash.

Senator **Moynihan**. In cash. I think Mr. O'Connell has said he agrees, and Drs. Keller and Clotfelter as well.

Mr. **O'Connell**. Can I add an important factor, Mr. Chairman?

Senator **Moynihan**. Sure.

Mr. **O'Connell**. Givers with incomes under $10,000 give three times more of their income—that is proportionately—than givers with incomes above $50,000. Givers with incomes under $5,000 give almost 5 percent of their income, and increasingly, it is those people with modest and low incomes who are the volunteers of our society.

Senator **Moynihan**. Thank you very much. Dr. Keller.

Dr. **Keller**. Mr. Chairman and Senator Moynihan, I just wanted to add that for the universities and colleges, what is an added feature is that people start habits of giving when they don't have much to give, and later on, when they have a lot to give, those habits are ingrained. And those are, in fact, the people who give us the large gifts later on.

Senator **Moynihan**. Out of every *x* number of Minnesota engineering graduates, one will donate a research lab someday. And it is very likely that this same benefactor started as a $10 giver in his first years out of school.

Dr. **Keller**. That is exactly right. They start out as first-year alumni, and that is what they are giving.

Senator **Moynihan**. And Dr. Murnane, is that your feeling?

Dr. **Murnane**. The very same thing is true at Tufts. We start with our students while they are enrolled, and they become givers while they are in their senior year and they continue on. They get in the habit, and they also learn a lot more about their university as a result of investing in it.

Senator **Moynihan**. Thank you. Mr. Chairman, I would like to ask Dr. Clotfelter another question, when my time comes around again.

The **Chairman**. Senator Durenberger.

Senator **Durenberger**. Thank you, Mr. Chairman. I just would like to ask one question. I am trying to find out what it is that we might all have in common as we approach tax reform and specifically income tax reform. I learned most of what I know about it first from Moynihan-Packwood and then from Packwood-Moynihan. And that is still where I am—worshipping in a sense—what we ought to be doing in tax reform. I am now learning more things from the chairman that relate to employee fringe benefits and a few other things, but one of the things we have in common is that we don't expect the Tax Code to be used to induce contributions. I mean, that isn't why we find it in the Tax Code—just because the Tax Code needs to be used as an incentive to contribute. Does anybody disagree with that theory? What I hear here is that most people say that you don't give because the Tax Code says you should give. Some people do, but that isn't really the reason that most people in America give. It is 200 or 300 years of tradition of giving. The Tax Code then plays some public policy role in that. Is that generally correct?

Dr. **Hale**. Yes.

Senator **Durenberger**. So, then, secondly, moving from that theory, what we are most concerned about is whether or not this particular form of income tax reform provides a disincentive for giving. Am I correct in that stand?

Dr. **Hale**. Yes.

Senator **Durenberger**. And the degree of disincentive that, Dr. Clotfelter, are there some elements that you have been able to identify that are the natural disincentives to giving? I haven't read your entire statement, but I have seen the comparison between various plans. What is it in the income Tax Code that is a predictable disincentive? What are the kinds of things we want to do if we want to make disincentives?

Dr. **Clotfelter**. I am not sure exactly how to answer that. I would say the difference between the present tax system and one of the ones that we are considering as alternatives is that the tax rates typically are lower, and the tax base more comprehensive, and that is the essence of this kind of tax reform. And because that tax rate is lower, you could call it a disincentive if you wanted.

Senator **Durenberger**. All right. Brian, let me finish this with you from the independent sector's standpoint. There are various ways to look at the public policy elements that are affected by income tax reform. We have a great debate going over the deductibility of State and local taxes. Some of us are arguing that the whole purpose of having deductibility is to alleviate disparity among States. And I made the comment here a couple of weeks ago that there are more undocumented workers in the city of New York than there are people in the State of Wyoming. Those workers are the responsibility of the mayor and the Governor and a lot of other people. So, we have been using the Tax Code as a form of Federal matching. By the same token, it strikes me that private contributions to alternative service delivery—alternatives from the Government—have been a part of this country for so long that all we should be doing with the Tax Code is making sure we don't cut into those services when reforming the tax system. We shouldn't be arguing, then, whether there are incentives or whether if we do this, this will happen. The best thing we ought to do is just say exclude this from income. Wouldn't that be the best? Exclude your contributions from your income, and everything else you can determine your tax from. Would that be a road to follow?

Dr. **Keller**. Mr. Chairman and Senator Durenberger, I think that is exactly it because the question isn't only one of incentives and counterincentives. It is inappropriate taxation of something that ought not to be taxed. It isn't an individual's income. It is something the person gave away. Do we really want to tax it? Are we not, in fact, changing the tradition by taxing something we didn't tax before—by taxing a scholarship, by taxing a gift of appreciated property? In the appreciated property situation, the present proposal would make it—would have a disincentive in the sense that it would be better for an individual to give that piece of property to his heirs than it would to give it to the university because that is one of the ways in which we see a difference and the treatment is actually preferential under the minimum tax calculation. So, I think if the Tax Code were neutral by excluding all charitable contributions from income, it would achieve exactly what you want to achieve.

Senator Durenberger. I have 20 seconds for Brian to respond. I take it, then, we create the problem that we must decide what is charitable and what is not, which nobody seems to be paying any attention to in this country. You can get through the IRS 301(c) loophole, and you are home free. That would be our problem, would it not?

Mr. O'Connell. Yes. We are working with the IRS, for example—one small example—on the definition of religion—what is appropriate to consider as religion. May I just respond to his question?

Senator Durenberger. Yes.

Mr. O'Connell. It is more than the dollars, as you have indicated. From the start, we as a society have determined that we are pluralistic, that problem solving—as the President says so well—is everybody's business, that every citizen should be involved in improving the community. More important than the dollars, it is that the way the Tax Code has encouraged contributions. It sent a signal to all of us that it is our policy as a people and our policy as a government that giving to the causes of one's choice is to be encouraged and that that is a basic good. And I think the other part of your question is: Does tax policy reflect social policy? In this case, even if it is passive, I think it should. It comes down to what kind of society we want to be, believe we must be, and how do we use every mechanism, including tax policy, to encourage just that kind of society.

The Chairman. Senator Matsunaga.

Senator Matsunaga. Thank you, Mr. Chairman. I don't know whether you have responded to this question or whether it has been asked or not, but according to a recent Congressional Research Service study, the reduction in tax rate called for in the tax reform proposals such as the Bradley-Gephardt, the Kemp-Kasten, and all the Treasury proposals—would represent a greater threat to future charitable giving than proposals to cut back on Tax Code provisions specifically designed to stimulate charity. Do you agree or not agree, or have you made any studies to make an assertion here?

Dr. Clotfelter. I am not familiar with that study, Senator. If the statement is that tax reform proposals that retain the deduction but cut rates might decrease contributions more than other kinds of tax reform proposals that keep our high rates and do something else, that is possible, but more than that I can't say.

Mr. O'Connell. I wonder if I might respond to this extent: That as we have discussed—before you did come in, Senator—the tax rate obviously has some impact on the size of gifts. To that extent, Bradley-Gephardt, for example, by only including charitable gifts at the lower tier of 14 percent, has the more marked negative impact on giving than the President's proposal, where giving might still be included for itemizers at 35 percent. What we have been saying is that we are not experts on tax policy and are somewhat helpless in what you decide to do about the rates. And as I said before, we would be silly to argue for high rates simply because it has some impact on the size of contributions. On the other hand, we feel it entirely reasonable to ask that the contributions be allowed as a deduction within whatever tax reform is passed. And if the rate is 35 percent or Bradley-Gephardt passes and has two tiers, the contribution should be deducted at the upper tier. So, we are willing to take some loss as the result of lowered rates, given the wisdom of this Congress as to what rates should be, but we are not willing to suffer other consequences of tax reform that are intentional.

Senator **MATSUNAGA**. Anybody else?

[No response.]

Senator **MATSUNAGA**. In 1981, I believe it was, when we were proposing the 1981 Tax Reform Act—it was the enhancement bill, I guess, that it was called——

Senator **MOYNIHAN**. Revenue enhancement.

Senator **MATSUNAGA**. Oh, revenue enhancement. We had representatives of charitable and other organizations testify here that, when the top rate in income tax was reduced from 90 percent to 70 percent, that they lost one-third of their contributions. Then, of course, we were proposing to reduce the 70 to 50, and they said that they would then lose another one-third of their contributions. What has been your experience along this line? Have you experienced the loss which was predicted by the representatives? I don't know whether you came here, Mr. O'Connell, or not, or Dr. Keller, or any of you—Dr. Hale or whoever it was—but I am wondering what that experience has been since we reduced the rate—the top rate—from 70 to 50.

Mr. **O'CONNELL**. In the absence of a representative of Treasury, let me give their figures. Their figures since 1981, when the rate was reduced from 70 to 50 and correspondingly down the line for other income categories, show that giving has declined substantially by persons with upper incomes. Indeed, at the level of $100,000, giving has declined, according to two estimates, by 15 and 19 percent. At the level of incomes above $200,000, giving has decreased almost 30 percent. So, clearly, giving has declined among upper income categories, and the organizations that say their loss is a third might reflect their profile of givers. It might be a museum. It might be a dance company. But clearly those dependent on big gifts from upper income categories have experienced an enormous loss of income.

Senator **MATSUNAGA**. Thank you. My time is up.

The Chairman. Senator Bentsen.

Senator **BENTSEN**. Thank you very much. I would assume if there appeared to be a strong likelihood of this bill going through that you will get a bunching up of contributions toward the end of this year, and you would have a dearth of them next year. Let me ask you about the question of unappreciated value. We work very hard at trying to see that everybody pays tax who makes a profit. A lot of us feel that that is necessary to keep credibility in the tax system. Obviously, we haven't done enough on corporations on that minimum tax, but we have done a pretty good job on individuals. Not many of them get by without it. But I note here that some of you, in your testimony, oppose the idea of the unappreciated value being included in the minimum tax. Now, how do you balance that off with our trying to see that everyone that really makes a profit in income pays a tax? Do you want to try that?

Mr. O'Connell. Let me just start off on it. In all of the discussions that I have had with these panelists and others, I know of no one who is opposing the imposition and strengthening of the minimum tax for individuals. On the other hand, I think all of us would argue that the inclusion of the gifts of appreciated property is inappropriate because, as Dr. Keller indicated, that seems to——

Senator Bentsen. Would you restate that, Mr. O'Connell? I am not sure I heard all your words.

Mr. O'Connell. I am sure that none of us is opposed to the imposition and the strengthening of provisions relating to the minimum tax for individuals. On the other hand, I think unanimously we would argue that, in determining—that is, in the way that is treated and the formula that applies to it—it is inappropriate to include gifts of appreciated property in determining the amount that will be taxed. That, in essence, discourages contributions. It will cause a loss of about $1 billion in lead gifts—lead gifts to universities, to museums, to church building campaigns.

Senator Bentsen. How are we going to differentiate then between a capital gains situation, which we have put into preference income, and appreciated property on which we get a deduction? I think you are contradictory when you say you are for strengthening the minimum tax and yet at the same time you don't want to put the appreciated value into the preference income tax.

Mr. O'Connell. I think the consistency comes in not taxing contributions. The policy has been to encourage contibutions, including the lead gifts.

Senator Bentsen. All right, but you are going to follow that in effect, and if the tax remained at 50 percent, he can get himself into a position where he pays no tax or virtually none.

Mr. O'Connell. He would be paying the minimum 20 percent on all other income. There are very few people who are going to escape the way the President's proposal is advanced, even if you remove that factor of the appreciated property given as gifts.

Senator Bentsen. That is assuming he has other preference items that would come under the 20 percent.

Mr. O'Connell. It is in almost all, I understand——

Dr. Keller. Ninety-three percent——

Mr. O'Connell. Ninety-three percent would have that other income.

Senator Bentsen. Now, where did you find that number?

Mr. O'Connell. He just whispered it to me. [Laughter.]

Senator Bentsen. Now, Dr. Keller, you will forgive me if, over these many years here, I have become something of a skeptic, when people say that is 68 percent. And what we have learned around here is that you do that with great conviction and that carries maybe through the day.

Dr. Keller. Mr. Chairman and Senator Bentsen, that is a number that has come out of an analysis from the American Council on Education, and within a week, we will have a full analysis presented. What it shows is that approximately 5 percent of the taxpayers in the $100,000 or above adjusted gross income are covered under minimum tax and that, if appreciated property were excluded from that calculation, only 7 percent of them would drop out of having to pay a minimum tax. And we will present within the week a full analysis of where those numbers come from that lead to that conclusion. The total number in that bracket is about 79,000 taxpayers.

[The prepared analysis follows:]

(Excerpt)

TAX REFORM AND CHARITABLE GIVING

Testimony by
Lawrence B. Lindsey
before the
House Ways and Means Committee

July 22, 1985
Washington, D.C.

Appreciated Property

The final point I would like to address today is the tax treatment of gifts of appreciated property. Gifts of property include such items as stocks and bonds, real estate, and works of art. The vast majority of these gifts are easily valued at market prices. Under current law, taxpayers may deduct the fair market value of these gifts for purposes of the Federal Income Tax. Gifts of property are therefore treated exactly the same as equivalent gifts of cash for purposes of the charitable deduction.

The President's proposal contemplates including the appreciated portion of these gifts as a tax preference for purposes of the minimum tax. The effect of this on the price of making a gift of appreciated property is shown in Table 2.

For illustrative purposes, consider the case of a small businessman who is nearing retirement. He has built up his business from scratch and now is considering selling it for $600,000. He also has about $50,000 in income from savings outside the business. He is considering donating $100,000 of the proceeds from the sale of his business to a charitable organization such as his alma mater.

Under current law, if he made such a gift, he would receive a tax deduction for the $100,000. Because he is in the 50 percent tax bracket, that deduction is worth 50 cents for every dollar contributed. However, by giving the away $100,000 of his property instead of selling it, he only has to pay capital gains tax on $500,000 of proceeds, not $600,000. As his capital gains tax rate is 20 percent, this saves him a further 20 cents on every dollar he contributes. The total tax savings is 70 cents, and the net cost of giving the property away is 30 cents per dollar given.

Under the President's proposal, this taxpayer would be subject to the minimum tax whether or not he contributes the property. By contributing the property, he receives a tax deduction for every dollar contributed. The minimum tax rate is 20 percent, and so the value of the deduction for making the gift is worth 20 cents on the dollar. However, the property he is giving away has appreciated in value, and so is treated as a tax preference item. The effect of this is to make him pay 20 cents for every dollar he gives away. So, the effect of the preference is to exactly offset the value of the deduction. But, had the taxpayer not given the property away, he would have had to pay capital gains tax on it. The effective capital gains tax rate under the minimum tax is 20 percent. Therefore, the net tax savings from making the contribution is 20 cents and the price of making the gift is 80 cents.

Contrast this 80 cent price with the effect of the original Treasury plan on the price of giving. Under that plan, taxpayers were allowed charitable deductions for the lesser of the property's fair market value or indexed basis. As the small businessman started the business from scratch, the basis is zero, and even after indexing is still zero. Therefore, the taxpayer was allowed no deduction for giving the property to a charity. However, that original proposal contemplated a capital gains tax rate of 35 percent, saving the taxpayer 35 cents for every dollar contributed. The net cost of giving, therefore, was 65 cents.

As I noted earlier, even if gifts of appreciated property were not considered tax preferences, this taxpayer would still be subject to the minimum tax. It is important to stress that the objective of guaranteeing that he pay at least a minimum amount of tax on his income is not contingent on the issue of the preferential tax treatment of appreciated property. However, the price incentive to contribute the property is greatly enhanced by removing appreciated gifts from the lists of tax preferences. If this taxpayer did not have to pay the 20 cent preference tax on his gift, his price of giving would fall from 80 cents to 60 cents, roughly what it was under the original Treasury proposal.

My simulations of the effect of the Treasury proposal found that there were about 80,000 taxpayers with AGI over $100,000 who would be subject to the minimum tax out of 1.5 million taxpayers with incomes of that amount. Although small in number, these taxpayers made appreciated property gifts of $2.96 billion out of total appreciated property gifts of $4.57 billion for all taxpayers with incomes over $100,000. In other words, 65 percent of all gifts of appreciated property made by high income taxpayers would be subject to this minimum tax treatment.

Even if appreciated property were not treated as a tax preference, 93 percent of the 80,000 minimum taxpayers would still be subject to the minimum tax. The overall integrity of the minimum tax as a means of ensuring tax compliance would not be affected. Furthermore, the remaining 7 percent of these minimum taxpayers would still be subject to significant ordinary tax liabilities.

It is important to realize that there is already in place a means of ensuring that taxpayers cannot eliminate their tax liability by making gifts of appreciated property. There is a limit of 30 percent of AGI on the amount of appreciated property gifts which can be deducted in any year. This limit is continued in the President's proposal. Therefore, even without treating gifts of appreciated property as a tax preference, the President's plan has a means of assuring that people who make gifts of appreciated property cannot escape taxation. The proposal to include these gifts in the minimum tax base is not only harmful to charitable giving, it is also unnecessary.

Thank you very much.

Table 2

Price of Giving Appreciated Property

Item	Current Law	President's Proposal	Treasury I
Gift	1.00	1.00	1.00
Deduction	- .50	- .20	0
Preference	0	+ .20	0
Capital Gains Tax	- .20	- .20	- .35
Net Cost	.30	.80	.65

Senator **Bentsen**. Dr. Keller, let me say that I feel very strongly that we ought to be encouraging contributions, and I think it is contradictory for the President, on the one hand, to talk about doing things at the local level and going through the private sector and then doing something that might deter that. But I am confronted with the other side of that problem in trying to see that everybody who makes money pays a tax.

Dr. **Keller**. Mr. Chairman and Senator Bentsen, I think that Mr. O'Connell suggested the argument we have made is that the minimum tax is intended to avoid people inappropriately using tax shelters, and we feel that a contribution of property is not something which is ultimately going to benefit that individual. That contribution is something which is, in effect, removing the property from the individual. It is giving it to some other purpose. And so, for the same reasons that we support the change that has allowed the use of appreciated property as a deduction for people who are beyond the minimum tax level, we believe that such appreciation should not be included it in the minimum tax provision. It is a question of treating those two in a consistent fashion and arguing for the fact that this is not a shelter. This is not a way of having people avoid taxes. It is a way of giving away something that they won't benefit from after that. There are other internal inconsistencies which, for example, under that minimum tax calculation would give a person an advantage if, instead of giving it away, the person put it into his estate. The proposed minimum tax calculation is such that in the one case, if it were given to a charitable purpose, it would count in the minimum tax calculation, but if it were given to an heir it would not. This is why some analyses have shown that, in fact, the current administration proposal in that single respect would actually make things somewhat worse than the original Treasury proposal. It would be a disincentive for giving away appreciated property.

Senator **Bentsen**. Thank you very much, Mr. Chairman.

The **Chairman**. Senator Moynihan.

Senator **Moynihan**. Mr. Chairman, it was my purpose to raise the subject that Senator Bentsen has just raised in the second round of questioning. Dr. Keller said earlier that charitable giving is not a tax shelter. And an important question arises from the President's proposal. What will be the effect of including appreciated property in the minimum tax calculations? As I understand it, these are the large donors; as compared to the $3 and the $5 givers we have been talking about with Dr. Hale and others. There is a form of charitable activity in this country which depends upon "lead grants." Dr. Murnane, I think you mentioned that word. I am talking about the first $1 million that is to be matched by other millions in order to begin the capital campaign for a research laboratory. We really need to look at this. This could be very important. I am wondering if we could ask Dr. Keller and Dr. Murnane to comment on the importance of this kind of gift. And I would ask Dr. Clotfelter if he could give us some idea of what the impact would be, particularly in the context of Dr. Keller's suggestion that the President's plan makes it much more beneficial simply to bequeath your wealth to your heirs. Could we ask Dr. Keller and Dr.

Murnane? What is the role of this kind of gift in large educational institutions, such as Minnesota and Tufts?

Dr. KELLER. Senator Moynihan, there are two or three ways of looking at it, all of which show its importance. One is that over half of all gifts in excess of $5,000 are given in the form of appreciated property, so that over half of those large gifts are in there. If you look at all giving to universities and colleges, about 40 percent of all of the giving comes in the form of appreciated property. As you go to larger and larger fundraising campaigns—the kinds of campaigns you have to get into to get endowed chairs, to get to the fundraising levels we are about to embark on at Minnesota—there is more and more of a dependence on appreciated property. As you go to larger fundraising campaigns, those lead gift items become even more important.

Senator MOYNIHAN. This gives you your chair in astrophysics?

Dr. KELLER. Exactly.

In the last 2 weeks, we have been able to garner four chairs because of a special fund in Minnesota. All four of them have come in the form of appreciated property.

Senator MOYNIHAN. Dr. Murnane, Tufts is a great research institution.

Dr. MURNANE. Yes; in answer to that. In addition to the endowed chairs the research facilities and the educational facilities—it was just going through my mind—we have put up around 16 buildings in the last 6 years, and donors that have been associated with those buildings, I think, almost exclusively use appreciated items.

Senator MOYNIHAN. That is where you get your capital from. For the record, a chair is a large sum of money deposited permanently to fund a professor's salary. It is a form of capital. Hale House gets its operating payroll money out of small contributions, and the United Way does the same. But this is a source of capital for universities.

Dr. MURNANE. That is right. On the annual operating money, we still have people who give us shares or——

Senator MOYNIHAN. But when we are thinking about capital formation in institutions of your kind, it comes in this mode.

Dr. MURNANE. Yes, sir.

Senator MOYNIHAN. Dr. Clotfelter, could you give us some estimates some time, when you have a weekend off and can sit down with your computer model? Or do you wish to do so now?

Dr. CLOTFELTER. I am not prepared to do that now, and I was not even prepared before Senator Bentsen's remarks, but I certainly wouldn't now. Lawrence Lindsay of Harvard University has been looking at this question, and I would suggest that he might be able to provide studies, and he is looking at specifically the question of the tax reform proposals' impacts on gifts of appreciated assets. It is a very complex question having to do with what is the basis of the gifts that are being given away and what is the alternative disposition of those assets.

Senator MOYNIHAN. We thank you very much, sir, and thank you, Mr. Chairman.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. No questions, Mr. Chairman.

The **Chairman**. That will conclude our testimony. Thank you very, very much. It was a very good panel and we appreciate it.

[Whereupon, at 11:18 a.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

Statement of

The American Legion

1608 K STREET, N. W.
WASHINGTON, D. C. 20006

from

PAUL S. EGAN, DEPUTY DIRECTOR
NATIONAL LEGISLATIVE COMMISSION
THE AMERICAN LEGION

to the

FINANCE COMMITTEE
U.S. SENATE

on

TAX DEDUCTIONS FOR CHARITABLE CONTRIBUTIONS

July 9, 1985

Mr. Chairman and members of the committee, The American Legion appreciates the opportunity to present its views on tax reform generally and on deductions for charitable contributions specifically. At the outset, it seems appropriate to establish the credentials of The American Legion as an organization heavily engaged in charitable undertakings across the nation. Each year, as required by our federal charter, we present an annual report to the Congress specifying our activities. A part of that report summarizes the local activities at the individual Legion Post Home level and is attached to this statement.

In the 1983-1984 year for which reports were received from less than half of all local Posts around the country, Legionnaires volunteered over one million hours of time at VA hospitals and donated another two and one half million hours of time in general community service. Aside from the time spent by volunteers, local Legion Posts around the country collectively donated several million dollars for the opperation of programs such as Legion baseball, Boy Scouts, school awards, scholarships, Special Olympics and several others designed to assist the nation's children and youth.

Without knowing how many of our members actually claim a deduction for charitable giving, it is impossible to say with certainity whether or not giving patterns would change if current tax law is changed. Under current law, beginning this year, nonitemizing taxpayers will be allowed to deduct 50 percent of their charitable contributions. Under the Administration's proposals for tax reform, charitable deductions would be available only to itemizing taxpayers. In our view, fairness ought to require equal tax treatment of itemizing and nonitemizing taxpayers. Accordingly, nonitemizing taxpayers ought to continue to avail themselves of the deduction for charitable contributions.

After having said this, we understand the Administration's reasoning for proposing a change in current tax law governing charitable contributions. One of the most appealing aspects of the overall tax reform debate is an apparent consensus on tax simplification. In the interest of simplification, the Administration's proposal would even make it unnecessary for nonitemizers to file a tax return. Were the deduction for nonitemizers retained, as we believe it should be, only those claiming the deduction by filing a tax return would benefit. In this way those individuals opting to claim the deduction could do so while those opting for simplicity could forfeit the deduction.

Clearly, tax reform proposals aiming to simplify the system must relinquish some aspects of equity and fairness. Just as clearly tax reform proposals aiming to achieve equity and fairness must relinquish some of the public policy leverage that the tax code provides. In that regard, the Congress is well advised to make a determination as to what it hopes to achieve with the tax code. Should the nation's tax laws, for example, constitute nothing more than a revenue generating machine or should the tax code be used to encourage individuals, groups, businesses or others to make decisions deemed economically or socially desirable? In our judgement, a combination of these twin tax law goals will most appropriately accommodate needs for revenues without forfeiting the public policymaking potential of the overall tax code.

In that regard, we strongly believe that existing deductions for charitable giving are closely connected to the amount donated to charities annually. To the extent that nonitemizing taxpayers can be encouraged to donate more to charity than they already do donate, we urge maintaining the deduction for nonitemizers in any tax proposal that emerges from this committee.

Another change in the tax law made last year, but taking effect this year, concerns the deduction allowed for the mileage driven by volunteers in the conduct of charitable activities. The change simply raises the per mile deduction from 9 cents to 12 cents. We raise this issue not because of any awareness of any proposal to reduce or eliminate this deduction. Instead we raise the issue because we believe nonitemizing taxpayers should be allowed this deduction if they engage in voluntary activities requiring the use of private automobiles. As with deductions for general charitable donations, fairness ought to require equal tax treatment of itemizing and nonitemizing tax paying volunteers.

Moreover, with the shrinkage of numerous federally funded programs, the government has a natural obligation to look seriously at what might be done to encourage volunteers to fill the voids left by reduced federal budgets. Providing a volunteer mileage deduction for nonitemizing taxpayers is one way of accomplishing this. Another would allow the per mile deduction to rise to the same average 22 cuts per mile level that benefits businesses using private automobiles in the conduct of business.

Today's need for volunteers is evidenced by lower federal spending, but the future need for volunteers particularly health care volunteers will become evident within the next decade. For those of us in the veterans community this conclusion emerges from a careful study of the growing numbers of aging veterans and of how well prepared the VA will be to address increased demand.

However, what applies to veterans also applies to the general citizenry and the greying of America will create a strong test of U.S. health resources and of health policy dexterity in adopting new health techniques for care of the aging. If what we believe to be the general direction in health care for the aging is correct, increased emphasis is being placed on treatment modalities that deinstitutionalize patients. This necessarily means increased reliance on in-home health care and local community resources. In our view the movement away from institutionalization and toward community and in-home care providers will require massive infusions of new volunteers.

In conclusion, our desire to seek retention of charitable deductions for nonitemizing taxpayers, addition of volunteer mileage deductions for nonitemizing taxpayers and an increase in the allowable per mile deduction for volunteers are all predicated upon our conclusion that public policy ends can be legitimately addressed through judicious use of the tax code. Being an organization of volunteers committed to service to the veteran, his family and dependents, we believe we are well qualified to recommend these adjustments in the tax code.

The American Legion also has an interest in other facets of the overall tax reform debate. However, since this hearing is restricted to the subject of charitable contributions, we will await another opportunity to express our additional concerns. Briefly however, the Legion is seeking a five year extension of the Targeted Jobs Tax Credit program and a similar extension of the handicapped access deduction for businesses that invest in facility adjustments to accommodate handicapped individuals on the job.

Mr. Chairman, that concludes our statement.

AMERICAN LEGION POSTS - 1984 CONSOLIDATED REPORTS NATIONAL SUMMARY

General	1981-82	1982-83	1983-84
Membership current year (as of reporting date)	1,602,533	1,493,834	1,475,046
Membership past year (final)	1,626,653	1,530,741	1,513,420
New members initiated	37,960	35,297	32,666
IRS Form 990 filed	3,975	3,854	4,132
Post home owned debt free	3,589	3,453	3,698
Post home rented	534	504	970
No cost for Post home	753	564	691
Other arrangement for Post home or meeting place	365	340	337
Rehabilitation			
Rehabilitation cases handled	471,768	258,195	308,202
Powers of attorney granted	63,833	44,495	43,092
Cash aid given veterans	$848,115	$790,555	$857,732
VAVS hours donated	1,018,754	965,109	957,043
Contributions to VAVS program*	-	$777,502	$915,229
Posts with Veterans Affairs and Rehabilitation Committee	1,462	1,426	1,438
Posts with Service Officer	5,667	5,452	5,577
Operation Post Home	2,320	2,248	2,304
National Security			
Pints of blood given	112,509	301,793	328,197
Legion blood donors	59,918	59,576	56,377
ROTC medals given	3,891	5,245	4,459
Posts with crime resistance program	971	957	986
Posts working with Red Cross in disaster relief	1,025	1,023	1,014
Public Relations			
Posts with Public Relations Chairman	3,812	3,580	3,689
Posts with regular paper or bulletin	2,910	2,773	2,832
Communications by cable television	444	494	596
Communications by radio	2,060	2,004	2,032
Communications by television	452	468	491
Communications by press	4,035	3,651	3,876
Posts with ½" VHS player/recorder*	-	504	700
Uniformed Groups			
Posts sponsoring color guard	3,779	3,622	3,735
Posts sponsoring firing squad	3,451	3,314	3,513
Posts sponsoring drum and bugle corps	180	166	140
Posts sponsoring band	156	149	190
Posts sponsoring drill team	364	373	349
Posts sponsoring other uniformed groups	269	276	297
Cost of uniformed groups	$1,505,759	$1,567,492	$1,473,928
Economic			
Posts with veterans employment program	1,142	1,101	1,237
Veterans assisted with finding jobs or training	26,874	20,412	24,344
Americanism			
Boys State			
Boys sponsored	16,979	16,110	18,118
Posts participating in Boys State	5,356	5,083	5,199
Cost of sending boys	$1,762,508	$1,740,851	$1,819,096
Baseball			
American Legion Baseball teams	2,127	2,033	2,057
Other athletic teams sponsored	2,321	2,314	2,185
Cost of all athletic teams	$5,984,372	$5,339,433	$5,928,406

Americanism (cont.)	1991-82	1982-83	1983-84
Boy Scouts			
Boy Scout units sponsored by Posts	1,458	1,418	1,485
Scouts in Legion-sponsored units	38,316	33,854	36,716
Cost to Posts	$466,551	$576,475	$647,245
School Awards			
School awards granted	21,050	20,482	20,730
Posts making awards	3,481	3,339	3,370
Cost of awards	$361,773	$381,464	$372,171
Oratorical Contest			
Posts active in program	1,236	1,099	1,093
Youths competing	5,119	4,897	4,683
Cost to Posts	$112,586	$120,693	$120,449
Education and Scholarships			
Number of scholarships awarded*	-	3,336	896 ← 3,896
Cost of scholarships	$830,284	$916,523	$985,059
Patriotic Events			
Posts observing Veterans Day	5,198	4,988	5,305
Posts observing Memorial Day	6,527	6,268	6,518
Posts observing July 4	3,578	3,545	3,544
Posts observing Legion Birthday	5,002	4,843	4,899
Posts observing American Education Week	1,181	1,207	1,173
Posts observing Four Chaplains Sunday*	-	1,321	1,311
Posts observing Flag Day**	-	-	3,574
Posts observing Get Out the Vote**	-	-	1,882
Community Service			
Hours given to community service	2,807,136	3,163,901	2,614,004
Posts reporting community service	4,532	4,206	3,957
Cost of community service**	-	-	$3,655,375
Children and Youth			
Cash aid given to needy children	$939,392	$1,110,053	$899,841
Value of goods given to children	$1,288,442	$1,468,864	$1,499,290
Children given aid (cash or goods)	175,673	168,009	378,679
Administrative costs**	-	-	$399,440
Parties and dinners**	-	-	$1,094,496
Prizes and gifts cost**	-	-	$615,685
All other expenses**	-	-	$996,980
Contributions			
United Fund	$160,784	$140,695	$138,866
Red Cross	$91,224	$100,869	$93,995
Cancer research	$141,644	$120,260	$155,344
Handicapped children (all types)	$541,256	$570,580	$630,329
Legislative			
Posts with active Legislative Chairman	2,334	2,197	2,207
Posts subscribing to National Legislative Bulletin	1,448	1,356	1,534
Energy			
Posts with Energy Committee	1,323	1,238	1,260
Percentage of all Posts reporting	47.78%	45.01%	48.15%

*new 1982-83 category
**new 1983-84 category

American Camping Association

1985 JUL 2

July 12, 1985

Committee on Finance
Room SD219, Dirksen Office Building
U. S. Senate
Washington, D. C. 20510

Dear Sirs:

You have recently held a hearing on the impact of tax reform on charitable giving. On behalf of the American Camping Association I would like to comment upon that matter.

The American Camping Association is an educational organization with a 501(c)(3) tax exemption. Our Association is composed of persons interested in organized camping for children, youth and adults and is the only body which accredits all types of children's camps. We have been a leader in developing standards for the camping field for 50 years.

Though we certainly benefit from the charitable contributions of our members and are concerned about the impact of tax reform on charitable giving to our organization, that is not our first concern. Our first concern is for the multitude of charitable camps across the country which serve children and youth through charitable gifts every summer. Many youngsters from low income and lower-middle income families are able to go to camp only because concerned individuals make contributions to the camps or their mother organization for camperships. In today's economic climate, those camps would not be able to continue their services without those charitable contributions.

Since the proposed tax reform would remove the charitable deduction for non-itemizers who comprise 80% of American taxpayers under this proposal, we feel there is a chance that many of those contributions would be lost to those camps and organizations. Though there is a strong commitment of the American people to charitable giving, the incentive of being able to deduct it from one's taxes oftens stimulates people to give when they otherwise would not. Since we have just recently made it possible for non-itemizers to really secure a charitable deduction for their gifts, it seems inappropriate after such a short period to eliminate it.

Bradford Woods, Martinsville, IN 46151-7902, (317) 342-8456

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I would also like to take this opportunity to urge that the proposed alternative minimum tax should not include as a "tax preference" item the appreciation element of capital gain property gifts to charity. The Department of Treasury has consistently allowed full-fare market deductions for appreciated property gifts, and to suddenly tack on this backdoor taxation seems inappropriate. Many such organizations as ours and those we represent receive major charitable gifts in this fashion and we feel those would be drastically reduced because of the lack of tax savings resulting.

The Association certainly knows there are many pressures on the proposed tax reform measures. At the same time, many cuts are being made in various aspects of federal spending. Many of those cuts will directly effect low income and lower-middle income families whose very services most of the charitable organizations serve. As increased services are requested of the non-profit sector, it is critical that charitable deductions be provided in our tax system to help undergird that private sector that must pick up the slack. That is a tradition that we cannot afford to lose.

Sincerely,

Armand B. Ball
Executive Vice President

ABB:fmm

arc

LEARNING
LIVING
GUIDANCE
INDUSTRIES

July 17, 1985

Congressman Dan Rostenkowski
2111 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Rostenkowski:

I am writing due to my concerns regarding the July 9 Senate Finance Committee hearing on the impact of tax reform proposals on charitable contributions.

The Association for Retarded Citizens of Allen County provides services to people who are mentally retarded and their families. We serve over 400 people in programs on a daily basis. The programs include infant services, therapies, sheltered workshop, educational and residential programs. Since March we have found jobs in the community for six individuals who are moderately retarded. We have started a machine shop and are training our people to do mill work. We have over fifty people living in the community semi-independently and forty-eight individuals living in group homes. Semi-independent means staff may be in contact with the individual once a week or whenever a need arises. I've enclosed further information about our programs and services.

The point I want to make is that the programs and services would not be possible without money. The funds that come to us through local, state and federal dollars are very necessary and appreciated. However, we have utilized the federal dollars we receive for services by early April. State and local dollars are also utilized. New programs, improving quality in existing programs, staff benefits and other opportunities all come as a result of volunteers and staff finding ways to cut costs, locate new funds and general donations.

I believe that by reducing the incentives for individuals to make contributions, those individuals would not contribute to charitable causes as readily. Consequently, the funds would not be available for agencies like ours to continue to do the good works that benefit the entire community.

I also believe the charitable deduction for non-itemizers should be made permanent. I understand that the tax law allows non-itemizers to deduct alimony payments. Please consider a "pro-family" tax proposal and consider the same treatment for charitable deductions.

Association for Retarded Citizens of Allen County, Inc., 2542 Thompson Avenue, Fort Wayne, IN 46807 / (219) 456-4534

The proposed alternative minimum should not include as a "tax preference" item, the appreciation element of capital gain property gifts to charity. Experts tell me this back-door taxation of the appreciation on charitable gifts is contrary to Treasury's decision to allow full fair market deductions for appreciated property gifts. Major charitable gifts would be drastically reduced.

I would urge that any new tax law continues to allow full fair market deductibility for appreciated property gifts and not placed for under the charitable deduction.

Thank you for the opportunity to comment on these issues.

Sincerely,

Stephen L Hinkle

Stephen L. Hinkle, M.S.
Executive Director

SLH/s

cc: Don Boness, President ARC Board
Senator Richard G. Lugar
Senator Dan Quayle
Congressman Daniel Coats

arc

B

THE GRADUATE SCHOOL OF THEOLOGY OF THE CHURCH OF THE BRETHREN

BUTTERFIELD AND MEYERS ROADS OAK BROOK, ILLINOIS 60521 TELEPHONE (312) 620-2200

July 17, 1985

Senate Finance Committee
C/O Betty Scott-Boom
Room SD-219
Dirksen Office Building, U.S. Senate
Washington D.C. 20510

Re: July 9 Senate Finance Committee Hearing on the impact of tax reform proposals on charitable contributions.

The charitable gift is an integral part of America and our free society. We cannot expect our government to do everything for its people. We must expect and encourage private initiatives in meeting the needs of our society.

Educational institutions like Bethany Seminary are dependent on the gifts of our constituents. These gifts are often made possible or are larger because of their tax deductibility. I urge you to retain the charitable deduction for those who do not itemize as well as for those who do.

Failure to retain the charitable deduction will place increasing loads on the public sector and will move our country toward socialization, ultimately discouraging individual initiative and creativity.

Thank you,

E. Floyd McDowell

E. Floyd McDowell
Director of Development
Bethany Theological Seminary
Oak Brook, IL 60521

Campbellsville College
200 College Street, West
CAMPBELLSVILLE, KENTUCKY 42718
502 • 465-8158

Submitted in connection with the July 9 Senate Finance Committee hearing on the impact of tax reform proposals on charitable contributions.

July 19, 1985

Ms. Betty Scott-Boom
Committee on Finance
Room SD-219, Dirksen Office Building
United State Senate
Washington, D.C. 20510

Dear Ms. Scott-Boom:

I am writing concerning proposed tax reform legislation. On behalf of private higher education in Kentucky, the private sector is very important to Kentucky and the nation. Independent higher education enrolls 14 percent of the college students in Kentucky and yet produces 19.7 percent of the graduates. Private higher education also produces 38.1 percent of the Chemistry degrees, 46.15 percent of the Physics degrees, 35.58 percent of the Biology degrees, 35.47 percent of the English degrees, 65.43 percent of the Economics degrees, 37.18 percent of the Mathematics degrees, 100 percent of the Rhodes scholars since World War II, and 50 percent of the Phi Beta Kappa Chapters in the state of Kentucky. You can readily see the importance of private higher education in Kentucky and in the nation.

An institution of the Kentucky Baptist Convention

I point out these facts in order to say that any law that would discourage charitable contributions to private higher education would be very harmful to our state and our nation.

Here are my thoughts and opinions:

1. The charitable deduction for nonitemizers (who will comprise 80 percent of American taxpayers under the Treasury's tax reform proposal) should be made permanent. I think it is interesting that nonitemizers are allowed to deduct alimony payments. I think that a "pro-family" tax proposal would accord the same treatment for charitable deductions.

2. The proposed alternative minimum tax should not include as a "tax preference" item, the appreciation element of capital gain property to charitables. This back-door taxation of the appreciation of charitable gifts is contrary to the Treasury's decision to allow full fair-market deductions for appreciated property gifts. Major charitable gifts would be drastically reduced. In fact, in the last three years, all gifts in excess of $25,000 to Campbellsville College have been in the form of appreciated property.

3. Treasury's original tax reform proposals call for a two percent floor under the charitable deduction, and limiting the charitable deduction for gifts of appreciated property. Although Treasury has withdrawn these proposals, there may be some inclination to revive them. I urge you not to include such a floor in any new tax law. It is very important that any new law continue to allow full fair-market deductibility for appreciated property gifts and not place a floor under the charitable deduction.

Sincerely,

Kenneth H. Pope

Kenneth H. Pope, Ph.D., CFRE
Advancement Vice President

Council
of Jewish
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Executive Vice President
Emeritus
Philip Bernstein

WASHINGTON DC
GA85

July 8, 1985

The Honorable Bob Packwood
Chairman, Committee on Finance
Russell Senate Office Building
Washington, DC 20510

Re: Hearings on Tax Reform; Impact on Charitable Giving

Dear Mr. Chairman:

This letter is submitted on behalf of the Council of Jewish Federations (hereinafter "Council"), pursuant to your announcement and invitation dated June 25, 1985, for the record of the hearings on July 9, 1985.

The Council, which is headquartered in New York City, is an association of Jewish community organizations located in 180 communities in the United States, including every major city. These organizations obtain contributions to provide a wide variety of humanitarian services to hospitals, institutions for care of the aged, agencies providing family and children welfare, youth and community centers, centers for students on campuses, vocational guidance, placement and rehabilitation services, and other forms of charitable and educational purposes, including futherance of the Jewish religion (all of which purposes are referred to herein for convenience as "charitable").

The organizations that are members of the Council, as well as the Council itself, are all classified as tax-exempt charitable organizations and as "public charities" under the tax laws.

The community organizations which are members of the Council derive their support principally from contributions from individuals, foundations and corporations.

General Policy

The Council is concerned about any changes in our tax laws which may inhibit support of charitable purposes and institutions. Support of the poor, the aged, the ill and others in distress, as well as dedication to community rehabilitation, safety and health, have all been essential elements in the responsible growth of our communities. This responsibility has been fully recognized under our tax system. The government, in its tax policy, has recognized that it should not deprive communities and social welfare institutions of their traditional support. In fact, tax policy has generally encouraged private sector support for such purposes in recognition of a national consensus that all individuals and entities should be encouraged to assume their share of community responsibility.

At this time, as government policy has sought to reduce taxes and, to that extent, to reduce some of the tax incentives for charitable giving, and as that policy further seeks to shift some of the responsibility for social welfare away from the Federal government and to the states and the private sector, it becomes even more important that the Congress be aware of the need to improve, through various means, the climate for charitable support from individuals, foundations and corporations.

As the Committee undertakes this major review and reexamination of our tax system, we respectfully urge that it take into account the importance - to the social welfare needs of this country - of all forms of support from the private sector.

The Committee undoubtedly will hear, during the course of its hearings, many suggestions growing out of studies as to the economic impact of the various tax reform proposals. We ask that the Committee consider sympathetically all such recommendations which are likely to maintain the private sector support for charitable funds and foundations, rather than those that adversely affect such support.

Congressional encouragement of charitable organizations of all kinds evidences one of the proudest attributes of the American people: private sector voluntary support for the efforts to meet human needs and improve the quality of community life. People are better off if they give. Giving patterns in a variety of forms are necessary in carrying out community responsibilities. We urge the Congress to keep in mind these principles in its review of the tax treatment of contributions to charitable organizations and that maintenance of appropriate encouragement to charitable giving will be welcomed by all responsible community-minded citizens and organizations.

Treasury I Proposals

Turning to specifics, the Treasury I proposals would affect charitable contributions as follows:

1. Individual charitable deductions would be limited to the excess over 2% of a taxpayer's adjusted gross income.
2. The charitable deduction for non-itemizers would be repealed.
3. Charitable deductions for gifts of appreciated property by individuals and corporations would be limited to their basis, adjusted by an inflation index.
4. The 50% and 30% limit on individual gifts to public charities would be repealed; also, provisions for carryovers of excess deductions would be repealed.
5. Deductions allowed corporations for gifts to public charities would also generally be unlimited, but deductions would be limited to 5% of taxable income in the case of gifts to private foundations, to any charity that owns more than 1% of the corporation's stock or to any charity controlled by persons who control the corporation. No carryovers would be allowed.

While the reduction in tax rates will, in some cases, leave more money available for charitable contributions, reliable studies have established that charitable giving would be adversely affected if these proposals are enacted. The Independent Sector has estimated that charitable contributions would be slashed 20%. In particular, it should be noted that in the case of contributions of appreciated property, which have been the source of most large lifetime gifts, the donor would no longer be able to deduct the fair market value of the property, but rather, only the basis (although the basis would be somewhat higher than under present law since it would be probably increased by an inflation index).

These Treasury I proposals are objectionable as a matter of policy for the following reasons:

(a) The charitable deduction should be recognized as involving different considerations from most other deductions and should not be governed by what may be convenient for the IRS to administer; thus, from a policy standpoint, the charitable deduction reflects important national policy purposes, i.e., encouraging private sector support of programs and policies in the public interest; limiting the allowance, as by a floor, reflects a contrary national policy.

(b) The charitable deduction should be regarded as reflecting a citizen's obligation and not as a loophole. The Treasury I proposals goes in exactly the wrong direction because it permits only certain taxpayers to take the deduction, which is simply not available to other taxpayers. Thus, only the wealthy will be able to take the charitable contribution deduction and, in their cases, the deduction will be an unlimited amount which will permit their tax burden to be substantially eliminated. This is the wrong policy, both from a tax standpoint and from the standpoint of confidence in the tax system.

(c) The Treasury I proposals do not provide simplification because they will require a complicated computation to determine.whether the taxpayer has contributed more than 2% of his income and an even more complicated computation where the taxpayer seeks to make a gift of appreciated property. The computation of basis and then an indexing adjustment certainly is more complicated than the present law. The present law has been in this form for reasons of simplification, because, in many cases with long-held capital gain type assets, the basis is not known.

From the standpoint of taxpayers' morale and public confidence in the tax system, Treasury I seems to have come up with a most peculiar policy, namely to make the charitable deduction available only to the rich (primarily, apparently, the rich with cash, but not for the "new rich" who have created a new business enterprise or otherwise built their wealth in the form of highly-appreciated property, securities, real estate, etc.).

President's Proposals

Fortunately, the President's proposal for tax reform does not include the complications of the Treasury I plan, except that it unfortunately would also terminate the charitable deduction for non-itemizers.

But, the President's plan would add another complexity that cannot be justified on revenue grounds. This is the proposal for a minimum tax of 20% which would include in items making up the alternative minimum tax base, the excess of the fair market value of appreciated property given to charity over the donor's basis in such property. The proposal does not call for indexing the donor's basis in the contributed property, as recommended in Treasury I.

This alternative minimum tax proposal would have the effect in some cases of up to a 20% tax on the appreciation in the value of property given to charity. This would be the equivalent of a capital gains tax under present law on such appreciation. It would also require most every donor of appreciated property to make a computation of the amount of the appreciation and all other items entering in the minimum tax computation to determine his or her exposure to such tax. This is not simplification. This is likely to create a disincentive to charitable gifts of property.

Summary and Conclusions

We have not attempted in this statement to evaluate the many other proposals for tax reform; but we urge the Committee to examine such other proposals on the policy principles stated above, namely, that the charitable deductions as now existing reflect important national policy. It relieves the government of burdens. It encourages a partnership of private sector support with governmental support in the public interest. The Committee should reject proposals, including those described herein, which add complexity - not simplification - and impede the growth of a major national asset, namely, the participation by as many citizens as possible in philanthropic endeavors.

Very truly yours,

Carmi Schwartz

Carmi Schwartz
Executive Vice President

LUTHERAN COUNCIL IN THE USA

Office for Governmental Affairs

122 C Street NW
Suite 300
Washington DC 20001
202 783-7501

Statement of
The Rev. Charles V. Bergstrom, Executive Director
Office for Governmental Affairs
Lutheran Council in the U.S.A.
on
Tax Reform and the Deduction for Charitable Contributions
submitted to the
Senate Committee on Finance

July 9, 1985

I appreciate the opportunity to comment on the tax reform proposals currently being considered by this committee--proposals which would have a significant impact on the churches I represent and on the voluntary sector as a whole. The following Lutheran churches participate in the Office for Governmental Affairs.

The American Lutheran Church, with headquarters in Minneapolis, Minnesota, which has 4,900 congregations and approximately 2.3 million members;

The Lutheran Church in America, with headquarters in New York, New York, which has 5,800 congregations and approximately 2.9 million members in the U.S.; and

The Association of Evangelical Lutheran Churches, with headquarters in St. Louis, Missouri, which has approximately 270 congregations and 110,000 U.S. members.

These Lutheran churches are deeply interested tax reform. In an earlier hearings before this committee I expressed in person the churches' concern that the growing tax burden on the working poor be eased. Through this statement for the record, I would like to express some of our concerns about the Administration's tax reform proposal, focusing on a key element which would seriously affect our organizations and the people they serve. Representatives of voluntary organizations testifying orally during this hearing have discussed in detail many of the concerns we share. The Lutheran Council is a member of the Independent Sector, and we would strongly endorse their extensive and well documented testimony.

When the Treasury Department released its tax reform blueprint late last year, we were deeply troubled by its proposal to establish a two percent "floor" for charitable contributions; coupled with the elimination of the charitable contributions for nonitemizers, this proposal would result in a significant decrease in charitable giving. We were pleased to learn that, in the Administration's proposal released in May, the "floor" had been rejected, along with a number of other proposals which which would have proven harmful to voluntary organizations.

However, we were very disappointed that the administration has included the proposal to accelerate expiration of the charitable contribution deduction for nonitemizers. Coupled with other changes in the plan, this will reduce dramatically the number of taxpayers who will be able to deduct their charitable gifts. As the Independent Sector's testimony illustrates, this will result in a significant reduction in gifts to educational institutions, to churches, to social service groups, to the range of organizations which make up the voluntary sector. This reduction will come at a time when our organizations, hit by cutbacks in federal funding which had been channelled through them, are experiencing an increase in the demands for services.

The Lutheran Council has long been a supporter of legislation to provide a charitable deductions for persons using the "short form." In 1979, the Council convened a nine day consultation on church-state issues, at which our most prominent theologians, lawyers, and public policy experts participated. In their policy recommendations, this consultation concluded:

> Allowing a separate charitable deduction for all taxpayers whether or not they itemize their other deductions would (a) represent an important incentive to personal giving to voluntary human services, (b) recognize the unique nature of the charitable deduction in contrast with other currently itemized deductions, (c) democratize the charitable deduction's based by extending its use to most middle and low-middle income taxpayers, (d) reverse the current trend toward decreased use of this deduction, and (e) avoid the regulatory and related governmental requirements associated with direct forms of federal assistance. Recommended: That the Lutheran Council continue to support legislation which would allow all taxpayers to take a deduction for their charitable gifts, whether or not they itemize their other deductions.

This statement was subsequently endorsed by the Lutheran churches in their national conventions.

Thus, we would urge this committee, as it develops its tax proposal this year to make permanent the charitable deduction for nonitemizers. We are strongly in favor of legislation (S361) which would make permanent this deduction, which without further action would expire at the end of 1986. Given the unique contributions of the voluntary sector to American life and the increased burden that charitable organizations are being asked to bear, approval of this legislation, either within the tax reform package or independently, is essential.

We appreciate this opportunity to share with this committee our views on this important issue.

TREASURY II TAX PROPOSAL
COMMENTS ON THE PROPOSAL

by

Minnesota Society of Certified Public Accountants
Committee on Federal and State Taxation

Authors: Lawrence E. Stirtz, CPA
David M. Senness, CPA

July 1985

The goals of the President's tax proposal in addition to reducing tax rates is to reduce the complexity of the tax code, to increase its fairness, and to change the code where it impedes economic growth. The Certified Public Accounting profession certainly endorses these goals both as citizens and as practitioners in the tax field. One of the long standing goals of the AICPA Tax Division is to assist and encourage policy makers in reducing the complexity of our tax system.

While we favor simplification in the tax code where it can be implemented, we also recognize that we live in a society and economy that is a complex one. We also recognize that simplification in and of itself often conflicts with fairness and flexibility. The structure of the current tax code is in many respects a series of responses to changing national economic conditions and the development of differing economic transactions that one expects in a dynamic free enterprise system such as ours.

Whether it is desirable to use the national tax policy to influence economic decisions or not it seems inevitable that it will continue to do so. We must recognize that any change in the tax law itself will influence economic decisions, and that the best policy to obtain economic neutrality with the system is a stable tax system. This has to be one of the lessons of the sweeping changes of the President's proposal and the recent past tax changes ushered in by the Economic Recovery Tax Act (ERTA 1981), the Tax Equity and Fiscal Recovery Act (TEFRA 1982), and the Deficit Reduction Act (DRA 1984).

A tax system that encourages the goals of simplicity, fairness, and incentive to growth that we all share should contain the following two elements:

> Flexibility to meet the needs of our changing environment. We are entering an international economy and have been doing so for many years. Prior to this time, the U.S. was the only major player and consequently we played very well. However, over the past few years many competitors have entered the arena. In order for us to compete effectively, we must have a tax policy that meets this challenge.
>
> Stability of concept over a long period of time so that the courts and the regulatory bodies such as the IRS can resolve and interpret areas of dispute. Hopefully a body of consistent law that is understood by both practitioners and government can be developed that will encourage certainty in the structuring of transactions.

Other papers with this submission address specific areas of the President's proposal where comment was deemed necessary.

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Testimony of

Peter M. Fannon, President
National Association of Public Television Stations

on Tax Reform and Charitable Contributions

before the

Finance Committee
U.S. Senate

July 9, 1985

America's 316 public television stations--all non-profit, non-commercial operations--rely on charitable contributions from individuals of all income levels and from businesses of all sizes for major and growing support. This support makes possible the public station's programming and other educational services to their communities, every day of every week, all year long.

In the past few years, when the federal contribution to our industry's total support decreased, public television has had to rely even more on voluntary contributions from individuals, families, and businesses. We are doing all we can to appeal for increased contributions, and to promote broader awareness of public television so that more viewers and users will contribute. And we are having some success.

But disincentives to continuing this effort--such as those I discuss below--would be devastating to our not-for-profit system. On top of severe reductions of federal, and sometimes local, cash support in the recent budget cuts, any setback to charitable giving would seriously undermine public television as a broad, alternative service, available nationwide. Indeed, I urge the Committee to promote increased private giving by maintaining and even enhancing tax incentives, so that public service industries, such as public television, can fulfill the public's expectations. Sensible, predictable tax treatment of any sort of charitable giving can and will help.

While we recognize the need to bring reforms to the present tax system, we are confident that some of the proposed changes to deductions for charitable contributions would adversely affect our fundraising efforts. The proposals that concern public television stations include:

(1) The placement of a limitation (based on percentage of gross income) on the amount that individuals who itemize can deduct for charitable contributions. Instead, we urge no change here.

(2) The possible elimination of the charitable deduction for non-itemizers. Instead, we urge enactment of a permanent deduction for non-itemizers.

(3) The Administration's new proposal for tax treatment of charitable gifts of appreciated property. Instead, we urge no change here.

The adoption of any of these proposals would harm public stations' fundraising efforts and most assuredly will harm the breadth, nature and number of programming and other community services they provide.

Public Television and Charitable Contributions--Individuals, Families, Businesses

Public television's 316 stations comprise the largest television system in the world and strive to make high quality educational, cultural and public affairs programs available to nearly 98% of our population. More than half of all television homes now watch public television every week, and over 85% view it every month.

Instructional television programs provided by public television stations were used by over 18.5 million school children in their classrooms in the 1982-83 school year, and more than 300,000 adults were enrolled in college credit telecourses during the 1984-85 academic year.

In terms of income, occupation, education, and race, public television's audience nearly mirrors the demographic profile of the entire nation. It is clear we are doing our job, providing alternative programs of interest and importance to nearly everyone. With increased funding we can and will do more and better.

As our number of viewers has increased, so has their willingness to contribute to their local stations. In response to the programming offered and as a reaction to serious cutbacks in federal funding, more viewers are believing that "TV worth watching is TV worth paying for." A survey conducted in the Spring of 1984 by Statistical Research, Inc., of public television membership in four public television markets (Syracuse, Boston, Madison, and New Orleans) showed that 76% of those stations' members contributed because of program offerings. In member households containing a child under 12 years of age, 81% specifically cited children's programming. And 51% of the members cited their local station's need and the worth of its cause as a reason for membership renewal.

A central element of improved service, however, will be increased support from individual and family viewers. It is their contributions which provide basic funding for both local and national programs. These contributions permit stations to produce or purchase programs that no other "funder" will support--government, business and foundation contributions very often are interested in only limited kinds of programs. So individual and family contributions take on special importance for the continued diversity and vitality of public television programming.

Subscriber support--contributions or "membership pledges" by individuals and families--is currently the fastest growing element of public television's income. Between 1981 and 1984, public television's income from membership increased 66%, from $95.4 million to $157.9 million (see attachment).

Membership income now comprises the largest share of total support for public television and radio stations. For public television, 20.2% of its total funds came from members in FY1984, exceeding federal support (16.1%) that year. In addition, our stations reported all-time records for this year's (FY1985) nationwide March fundraising campaign (March 1985) in terms of the total number of viewer pledges, total dollars pledged, and the size of the average gift.

Stations receive contributions from viewers of all ages and income levels. Many stations receive donations of a dollar, or of a week's allowance, from young viewers of Wonderworks, Reading Rainbow, The Electric Company, and public television's science and nature programs. This year, many stations experienced their most successful night of on-air pledging during the final episode of The Jewel in the Crown. For some stations, it might have been Nature; others might have attracted large sums during Frontline or NOVA or Live from the Grand Ole Opry.

For better or for worse, public television's on-air fundraisers are almost as famous as our programs. Well organized and staffed by development professionals and more than 200,000 volunteers nationwide, these fundraising campaigns and related efforts raise more money nationally than any other charitable group except the United Way of America.

Nearly four million individuals or families are members, and our stations devote significant resources from their tight budgets to seeking new members and new avenues to encourage private support. We believe that any loss of the tax benefits that members may receive for their loyalty might well discourage their continued giving at current levels, undercut a means of promoting new giving, and increase our difficulty in raising charitable funds.

Of equal importance to the financial health of our stations are contributions from business. Representing the second fastest growing sector of public television's income, income from business contributions in FY1984 was $123 million, 13% of total income. Our stations rely on businesses to support major new national programs and to contribute in their communities to maintenance and improvement of local stations. In addition to financial contributions to our stations, businesses regularly provide in-kind services and auction donations to our stations and to producers.

We expect our contributions from businesses to continue to increase. Given the substantive changes in business tax treatment since 1981, however, many corporations are just now beginning to restabilize their plans to help non-profit organizations. Any new changes would force corporations to plan with less certainty for future giving.

Recommendations on Current Tax Proposals Affecting Public Television

Our membership was relieved to hear that President Reagan had dropped the original Treasury Department proposal to restrict charitable deductions to contributions exceeding 2% of gross income when he presented his tax reform plan to the American people. The losses to charities nationwide estimated from that propoal would have been felt by all the members of the public television community.

Our member stations supported the initiation of the charitable deduction for non-itemizers in the 1981 Economic Recovery Tax Act and would like to see the deduction made a permanent provision of the Tax Code. Any move designed to allow the deduction to end or to accelerate its expiration date would defeat the main goal of tax reform--fairness in the tax code for all Americans. We support Senator Moynihan's and Representative Frenzel's effort through S.361 and H.R.587 to retain the non-itemizers' right to deduct from their taxes any contributions to the charities of their choice.

The proposal within the President's tax reform plan to allow donors of appreciated property to charities to deduct only the original value of the property when figuring their minimum tax is also of great concern to public television stations who conduct large local auctions to raise funds. In FY1984, income from on-air auctions contributed nearly $22 million, or almost 3% of public television's total income.

Public television auctions regularly include donations from local businesses and individuals. Some of our stations conduct large wine auctions with donations from private cellars; others hold special auctions of art and antique donations from artists, collectors, and viewers. This year, our member station KQED in San Francisco raised nearly $300,000 by auctioning off a house and a condominium donated by a local developer.

Independent studies have shown that $1.6 billion in gifts of appreciated property to charity generally would be lost as a result of the President's proposed change in tax treatment of gifts of appreciated property, bringing the national $4.5 billion total of gifts of appreciated property to $2.9 billion.

Decreases of this scale in gifts of appreciated property to public television stations would be devastating, perhaps even forcing this successful means of fundraising off the air.

Our member stations recognize that taxpayers' deductions for contributions are not the sole reason for philanthropic giving in America. We also recognize that if the end result of any major tax reform will be fairness and simplicity for all taxpayers, we should all work toward that goal. Individuals who support organizations serving the public good, however, should be encouraged to continue that support, and should receive equal reward for their sacrifices regardless of their income levels or tax classification.

This nation's public television stations are now responding to the challenge of severe cutbacks in federal funding earlier in this decade. They are using sophisticated, ingenious methods of reaching viewers and making them supporters. Any move by the federal government to make that challenge more difficult would be at best counterproductive.

NAPTS
June 13, 1985

UNDUPLICATED PUBLIC BROADCASTING INCOME
1978 - 1984
(IN THOUSANDS OF "CURRENT" DOLLARS)

SOURCE OF INCOME	SYSTEM	FY 1978		FY 1979		FY 1980		FY 1981		FY 1982		FY 1983		FY 1984*		SIX-YEAR PERCENT CHANGE
		AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PERCENT	
TOTAL INCOME	Total	552,325	100.0	603,466	100.0	704,857	100.0	768,895	100.0	845,214	100.0	899,172	100.0	970,966	100.0	75.8
	TV	469,836	100.0	504,829	100.0	581,418	100.0	626,120	100.0	680,742	100.0	720,444	100.0	783,636	100.0	66.8
	Radio	82,489	100.0	98,637	100.0	123,439	100.0	142,775	100.0	164,472	100.0	178,735	100.0	187,330	100.0	127.1
FEDERAL	Total	160,762	29.1	163,229	27.0	192,540	27.3	193,669	25.2	197,625	23.4	163,772	18.2	166,598	17.2	3.6
	TV	133,546	28.4	129,823	25.7	152,396	26.2	148,356	23.7	150,134	22.1	122,929	17.1	126,346	16.1	-5.4
	Radio	27,216	33.0	33,406	33.9	40,144	32.5	45,313	31.7	47,491	28.9	40,793	22.8	40,252	21.5	47.9
NON-FEDERAL	Total	391,563	70.9	440,237	73.0	512,317	72.7	575,226	74.8	647,589	76.6	735,457	81.8	804,368	82.8	105.4
	TV	336,290	71.6	375,006	74.3	429,022	73.8	477,764	76.3	530,608	77.9	597,515	82.9	657,290	83.9	95.5
	Radio	55,273	67.0	65,231	66.1	83,295	67.5	97,462	68.3	116,981	71.1	137,962	77.2	147,078	78.5	166.1
LOCAL GOVERNMENT	TV	36,844	7.8	39,315	7.8	31,898	5.5	35,519	5.7	33,685	4.9	36,372	5.0	34,855	4.4	-5.4
	Radio	7,393	9.0	8,450	8.6	7,919	6.4	8,882	6.2	8,668	5.3	8,654	4.8	10,866	5.8	47.0
STATE GOVERNMENT	TV	110,766	23.6	126,418	25.0	145,055	24.9	134,472	21.5	152,623	22.4	156,686	21.7	170,356	21.7	53.8
	Radio	5,222	6.3	6,002	6.1	8,767	7.1	10,038	7.0	13,892	8.4	17,756	9.9	15,119	8.1	189.5
STATE COLLEGES & UNIVERSITIES	TV	35,851	7.6	38,559	7.6	41,445	7.1	50,683	8.1	51,146	7.5	54,437	7.6	56,832	7.3	58.5
	Radio	22,107	26.8	24,775	25.1	28,635	23.2	31,283	21.9	34,110	20.7	35,699	20.0	36,414	19.4	64.7
OTHER COLLEGES & UNIVERSITIES	TV	2,986	0.6	4,220	0.8	12,711	2.2	10,985	1.8	11,867	1.7	23,410	3.2	20,349	2.6	581.5
	Radio	4,521	5.5	4,533	4.6	7,648	6.2	7,827	5.5	7,917	4.8	9,030	5.1	7,893	4.2	74.6
FOUNDATIONS	TV	15,942	3.4	18,426	3.6	19,518	3.4	15,018	2.4	17,917	2.6	20,389	2.8	22,309	2.8	39.9
	Radio	1,271	1.5	1,976	2.0	4,020	3.3	4,235	3.0	4,191	2.5	4,539	2.5	5,068	2.7	298.7
BUSINESSES	TV	44,825	9.5	53,101	10.5	62,515	10.8	77,161	12.3	83,700	12.3	98,574	13.7	123,132	15.7	174.7
	Radio	4,145	5.0	4,791	4.9	9,880	8.0	9,684	6.8	16,786	10.2	21,249	11.9	19,736	10.5	376.1
SUBSCRIBERS	TV	53,834	11.5	61,313	12.1	73,060	14.5	95,117	15.2	120,124	17.6	146,587	20.3	157,948	20.2	193.4
	Radio	7,035	8.5	9,277	9.4	11,751	9.5	15,658	11.0	21,952	13.3	28,887	16.2	34,312	18.3	387.7
AUCTIONS	TV	13,813	2.9	15,595	3.1	16,931	2.9	19,376	3.1	19,702	2.9	20,217	2.8	21,870	2.8	58.3
	Radio	534	0.6	497	0.5	558	0.5	687	0.5	690	0.4	746	0.4	676	0.4	26.6
ALL OTHER	TV	21,429	4.6	18,059	3.6	25,889	4.5	39,433	6.3	39,844	5.9	40,843	5.7	49,639	6.3	131.6
	Radio	3,045	3.7	4,930	5.0	4,117	3.3	9,168	6.4	8,775	5.3	11,367	6.4	16,994	9.1	458.1

Data Source: Corporation for Public Broadcasting

* 1984 data "preliminary" (May 1985)

NUVEEN

John Nuveen & Co. Incorporated
Investment Bankers

140 Broadway
New York, New York 10005-1190

Telephone 212 208 2300

July 9, 1985

1985 JUL 11 [illegible]

Senate Finance Committee
Washington, D.C. 20510

Gentlemen:

I am writing relative to the impact of tax reform proposals on charitable contributions. My interest in this subject is based upon my continuing financial support of a number of non-profit organizations as well as my role as Trustee of Bates College, Lewiston, Maine; Chairman of the Development Committee of Admiral Farragut Academy, Pine Beach, New Jersey and as a member of the Board of Associates of the Yale Divinity School, New Haven, Connecticut.

I believe that non-profit institutions can suffer irreparable damage if current tax incentives for contributors are modified or eliminated. The private sector is being asked to undertake a greater financial responsibility for non-profit organizations now and in the future if the Federal Government modifies or eliminates many of its social welfare programs. I believe that the private sector can accommodate this additional financial burden, but only through meaningful tax incentives.

The charitable deduction for nonitemizers should be made permanent. The loss of this deduction would adversely impact the highest number of donors to our nation's non-profit institutions.

The tax law allows nonitemizers to deduct alimony payments. It would seem that a pro-family tax proposal should accord the same treatment for charitable deductions.

The proposed alternative minimum tax should not include (as a tax preference item) the appreciation element of capital gains property gifts to charity. It seems inconsistent that Donor A who held growth stocks for many years could receive a deduction based upon current market value, while Donor B who invested in real estate (or other property) for a similar period of time would be denied a portion of the current market value of the gift. Appreciated property represents a high percentage of the major gifts of most charities, so any tax disincentive could seriously curtail this vital source of revenue.

I urge that any new tax law continue to allow full fair market deductibility for appreciated property gifts, and that no "floor" be placed under the charitable deduction.

Our country's non-profit organizations perform services vital to our society at the lowest possible cost. It should be our goal to turn over as many of the Federal Government's social welfare programs to the private sector as possible. Individual and corporate taxpayers can assume a growing financial burden, but only if they are encouraged to do so through tax incentives.

The alternative is for the Federal Government to assume a greater portion of the financial burden. This would be both inefficient and fiscally irresponsible (based upon our current federal deficit).

Very sincerely yours,

Frank P. Wendt
Chairman of the Board

FPW:ab

Stephens College
Columbia, Missouri 65215 • (314) 442-2211

July 18, 1985

Ms. Betty Scott-Boom
Committee on Finance
Room SD-219
Dirksen Office Building
U.S. Senate
Washington, D.C. 20510

Dear Ms. Scott-Boom:

Enclosed is my written statement submitted in connection with the July 9 Senate Finance Committee hearing on the impact of tax reform proposals on charitable contributions.

Sincerely yours,

Marguerite F. Taylor

Marguerite F. Taylor, Ph.D.
Executive Director
College Advancement

MFT:jc
Enclosures

BEST COPY AVAILABLE

STATEMENT RE: The impact of tax reform on charitable giving

SUBMITTED BY: Marguerite F. Taylor, Ph.D.
Executive Director for College Advancement
Stephens College
Columbia, Missouri 65215

1. For 153 years, Stephens College in Columbia, Missouri, has been a leader in quality education for America's women. The more than 40,000 living alumnae and others whom we serve would be harmed by decreased contributions that would result from removing or watering down tax incentives to giving.

2. The charitable deduction for nonitemizers (who will comprise 80 percent of American taxpayers under the Treasury's tax reform proposal) should be made permanent. The tax law allows all taxpayers to deduct their alimony payments, whether they itemize or take the standard deduction. I do not suggest changing that rule. But your "pro-family" tax proposal should keep the same treatment for charitable deductions. I urge you to make it an All-American charitable deduction--available to itemizers and nonitemizers alike.

3. The proposed alternative minimum tax should not include, as a "tax preference" item, the appreciation element of capital gain property gifts to charity. This back-door taxation of the appreciation on charitable gifts is contrary to Treasury's decision to allow full fair market deductions for appreciated property gifts. Major charitable gifts would be drastically reduced to our nation's private colleges, hampering quality education for the youth of America.

4. I also urge that any new tax law continue to allow full fair market deductibility for appreciated property gifts and not place a floor under the charitable deduction.

To:
Senate Finance Committee

From:
Roger Courts, Director
Sacred Heart League, Inc.
Post Office Box 300
Walls, Mississippi 38680

Date
July 23, 1985

Subject
Statement on the Impact of Tax Reform
Proposals on Charitable Contributions
In connection with the July 8 , 1985
Senate Finance Committee Hearing

Introduction

The Sacred Heart League, Incorporated, is a Catholic non-profit corporation doing business, in Walls, Mississippi. The Sacred Heart League supports a variety of programs and projects to promote Christian values. The Sacred Heart Auto League is an association of members who commit themselves to prayerful and careful driving in the name of the Sacred Heart of Jesus. The Apostolate of the Printed Word of the Sacred Heart League publishes and distributes prayer books and other religious and devotional books, pamphlets and prints. The Sacred Heart League also supports a host of projects and services of the Sacred Heart Southern Missions which is engaged in Catholic Missionary work in nine counties of north Mississippi. These include the building and staffing of churches, educating young children and providing homemaker, health and social services to the poor, primarily those who are either elderly or children.

THE APOSTOLATE OF THE PRINTED WORD

The Sacred Heart League strives to bring hope and encouragement to people in their daily lives. In addition to distributing religious publications to individual League members, a significant quantity is provided to coordinators of ministries to people in nursing homes, hospitals, prisons, the armed services and religious education programs. In many cases budgets do not exist to provide inspirational reading materials - - a dire need cited by many who ask for our literature. Through the generosity of our donors, we were able to supply more than 525,000 religious and devotional books and booklets to such ministries in the past fiscal year.

Without our donors ability to support us, we would be unable to fill requests when groups are unable to cover our cost. Thus, shut-ins, the aged, the sick, the men and women in the military and the imprisoned trying to sort out their lives, would not have even this meager element of hope and encouragement.

SOCIAL SERVICES OF THE SOUTHERN MISSIONS

Nearly one-third of the money spent on service programs by the Sacred Heart League goes to support the activities of the Sacred Heart Southern Missions. It provides a host of services to elderly poor through the social service teams who perform a variety of tasks in the home which range from doing the laundry to insuring that medicine is taken as prescribed. In large measure these services enable poor elderly, despite advanced age and failing health, to stay in their own homes for a longer period of time before institutionalization becomes necessary. While maintaining life at home in familiar surroundings adds dignity and purpose to the lives of the elderly, it also forestalls the added expense to the state and county for housing, caring and feeding of aged individuals. Without exception the elderly served by the Sacred Heart Southern Missions would be housed in state or federally supported homes as they are welfare recipients who do not have the means to qualify for any private retirement or nursing homes.

One of the schools of the Southern Missions serves a predominately Catholic population, but its true costs still must be subsidized by League members who want to help ensure the continued Catholic education of youngsters in a Catholic home missions territory like north Mississippi. Without financial support of this school, the only Catholic grade school in 9 counties of north Mississippi, nearly 500 boys and girls each year would be deprived of a quality Catholic education. Many non-Catholics also benefit through this program of quality education.

CADET SCHOOL

In the other school operated by the Sacred Heart Southern Missions the children are poor. This is an intensive, remedial, rehabilitative compensatory educational program specially designed to meet the needs of poor kids in Holly Springs, Mississippi. The parents are required to pay a nominal tuition, to encourage some sacrifice on their part and greater participation in their child's education. But, the major portion of the cost is again bourn by League members who want to give poor Black children a chance to succeed within the educational and social structures of this country. They are giving needy kids, who come from generations of poverty, the chance to break out of that cycle and avoid a life of limited opportunity. Without help, social and educational disadvantages, which are already present at age four or five, severly limit a child's chance for educational success and ultimately success in life. Without the intensive specialized education they receive in our schools, the prospect for these poor children is that they will continue to depend on the welfare system rather than become productive contributors to their community. Each year nearly 1,000 boys and girls are aided through the educational programs of the Sacred Heart Southern Missions which are funded by the Sacred Heart League.

MISSIONS CHURCHES

Contributions are also used to further the growth of the Catholic Church in Mississippi. Churches, educational and social halls are built and staffed in nine counties through the generosity of League donors/members. They are helping to promote religious values and build stronger families. In this area of Mississippi, Catholics make up just a little more than 1% of the population. Without the assistance of other Catholics across the country, the small groups of local Catholics would find it extremely difficult to purchase the land and build the churches needed for their congregations.

LEAGUE MEMBERS

The Sacred Heart League is assisted in all these endeavors by a nationwide membership numbering in an excess of 1.1 million. These members funded program services in the 1984 fiscal year which amounted to more than $7,500,000.00.

CLOSING REMARKS

A recent survey of these donors identified their average annual income at $21,000 - - solidly within the administration's concept of what constitutes the middle class. When asked in this same survey, about the importance of a tax deduction, less than half felt the presence of a tax deduction was *unimportant*.

While we have no statistics on the percentage of these people who do itemize their tax deductions, without question the Treasury's Tax Reform Proposal will put virtually everyone of our supporters in a category of non-itemizer. At the same time to eliminate the charitable deduction for non-itemizers would be to deliver a double blow to those who provide the majority of our financial support.

For traditional Catholics it may be considered unseemly to acknowledge - - especially to a Catholic organization they support - - that a tax deduction is of importance when making a charitable contribution. However, to assume that the deduction is not an additional incentive or that it is unused would be incorrect. Indeed, complaints can surely be expected when any lessening of tax deductibility occurs. And what is more important, a decrease in contributions could be expected to also follow.

Furthermore, if the Federal Government is expecting the non-profit organizations to become more and more responsible for meeting a host of needs of our country's population, the government should make it easier, not harder, for individuals to support such non-profit service groups. Discouraging support by limiting or eliminating tax deductions will certainly hamper the ability of non-profit organizations to meet growing needs left in the wake of the Federal Government's reduced role.

We urge you to continue the charitable deduction for non-itemizers and to do all you can to extend the Federal Government's encouragement to individuals to support charitable and eleemosynary organizations throughout the United States.

United Methodist Foundation of Western North Carolina Inc.
3400 SHAMROCK DRIVE • P.O. BOX 18005 • CHARLOTTE, N.C. 28215 • 704/535-2260

EXECUTIVE DIRECTOR
RICHARD D. BAILEY

July 10, 1985

Betty Scott-Boom
Committee on Finance
Room SD-219
Dirksen Office Building
U.S. Senate
Washington, DC 20510

Dear Ms. Scott-Boom:

Subject: Written Statement for the Record on Impact of Tax Reform on Charitable Giving

Attached to this letter are six copies of a written statement for the printed record in lieu of a personal appearance at the July 9, 1985 public hearing on the impact of tax reform on charitable giving.

Also enclosed are 50 additional copies of the statement for the press and interested persons.

How may I order a copy of the printed record on this public hearing?

Sincerely,

Richard D. Bailey

Richard D. Bailey
Executive Director

Enclosures

PRESIDENT BOARD OF DIRECTORS - TED S. [illegible], JR. • VICE-PRESIDENT HELEN COVINGTON • SECRETARY GOLDSTON F. HARRIS • TREASURER JOHN R. SILLS
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WRITTEN COMMENTS

IMPACT OF TAX REFORM ON CHARITABLE GIVING

COMMITTEE ON FINANCE
UNITED STATES SENATE

PUBLIC HEARING
JULY 9, 1985

RICHARD D. BAILEY

SUMMARY

The President's proposal for comprehensive tax reform would repeal the charitable contribution deduction for nonitemizers. If this proposal is enacted, only 15 to 20 percent of taxpayers will itemize deduction. This would eliminate the contribution deduction for about 80 percent of all Americans, and chairities would lose up to $9.8 billion annually ($5.6 billion from loss of non itemizer deduction; $4.2 billion from a lower marginal tax rate and other changes).

Charities are accepting significantly decreased charitable giving that will result from lower marginal tax rates, and, as the President has asked, have taken on added responsibility by providing some of the services no longer financed by Federal tax dollars. What charities cannot accept is repeal of the charitable deduction for four out of five tax payers.

The charitable deduction should be available equally to all Americans. Charity should be everyone's concern and responsibility. Indeed, recent polls show that 81 percent of all Americans approve of the charitable deduction, even those who do not take the deduction themselves. They favor keeping this tax incentive themselves because its social value outweighs personal interest.

RATIONAL

Since the inception of the income tax, Congress has wisely exempt from tax assets that are given away to causes in the public good, rather than consumed for personal benefit. The contribution deduction is a proper incentive to encourage support of worthwhile causes that improve the quality of life in our nation --college and universities, hospitals and health care institutions, Boy Scouts and Girl Scouts, Salvation Army, the arts, drug rehabilitation programs, churches and synagogues, and a host of others.

Volunteerism --the willingness of our citizens to give of their time and assets to worthwhile causes-- is the root of the American spirit. Although persons do not give because of tax incentives, they do give more because of them. If charitable giving is reduced, the effect on Federal budget cuts is likely to be compounded. Federal spending on human services declined by $50 billion between 1982 and 1985. It is in this area that the President has asked the private sector to increase services.

The late Hubert Humphry observed, "The impersonal hand of Government can never replace the helping hand of a neighbor." If Congress wishes to reduce spending in human services programs, and at the same time ask American charities to increase services, please do not change the current charitable giving incentives.

TREASURY'S RATIONAL FOR REPEALING THE NONITEMIZER DEDUCTION

Treasury's assumption on the reason for repealing the nonitemizer deduction are weak and not relevant to fact. They claim the ZBA (zero bracket amount) is "generally regarded as an allowance for certain personal exemptions that ought not be included in income and that all taxpayers are deemed to incur" which makes this a double deduction for nonitemizers. Historically, the standard deduction (ZBA) was a threshold to the tax system and was never meant to contain "certain personal exemptions".

Treasury says the nonitemizer deduction is "administratively burdensome" for IRS and "complicated for taxpayers". Substantiation of charitable contributions is no more burdensome than any area of substantiation, nor is it complicated for the taxpayer.

Treasury says there is little data that the nonitemizer deduction has "significantly increased charitable giving". The nonitemizer deduction was phased in over a five year period which included tax years 1982-1986. The ceiling in 1982 and 1983 was $25; in 1984, $75. In 1985 the ceiling is 50% of all charitable gifts; and in 1987 all charitable gifts may be deducted by nonitemizers. This deduction needs the full phase in period to show its value and positive contribution to American society.

Treasury has offered no facts to show abuse of the nonitemizer deduction. If necessary, substantiation rules may be tightened. The deduction should remain.

TAX FAIRNESS AND TAX REFORM

In any tax reform plan, tax fairness is of major importance. The charitable contribution deduction should be available equally for all Americans, those who itemize and those who do not itemize. Eighty five percent of all contributions come from families with incomes under $50,000 a year. It is these generous contributors who will lose their charitable deduction under the President's proposal.

America truly becomes America by what she enables its citizens to give. Please keep the charitable contribution deduction for all Americans.

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Mr. Bailey is executive director of the United Methodist Foundation in Western North Carolina, 3400 Shamrock Drive, Charlotte, NC 28218 (704/535-2260).

1985

July 22, 1985

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The Honorable Bob Packwood
Senate Finance Committee
440 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Packwood:

The YMCA of the USA appreciates the attention given by the Finance Committee, in its hearing July 9, to the implications for charitable giving of the Administration's tax reform proposal. We are particularly concerned about the proposal to eliminate the deduction for charitable contributions by nonitemizers. We ask that this letter be made part of the hearing record.

The YMCA of the USA strongly supports the nonitemizers' deduction for charitable contributions. Supporters of the YMCA give of their money (and their time) because they believe in the work of the Y and in its principles. Tax deductions, however, can influence the size of their gifts. This incentive to additional giving should not be limited to the wealthy, especially since as many as 85% of taxpayers would not itemize under the Administration's proposal.

A deduction for charitable contributions does not benefit the taxpayer. Charitable contributions support the public good. Individuals in need of services benefit, as does the society as a whole. In the YMCA, charitable contributions of all sizes are used -- and needed -- to support a wide range of programs, from summer camp scholarships for low-income children to training and placement programs for unemployed youth, from meals for the elderly to physical fitness and recreation for the disabled.

Loss of the charitable contributions deduction for nonitemizers would likely cause charitable giving to decline by an estimated $5.6 billion a year. This is on top of an estimated drop in giving of $4.2 billion (under the Administration's proposal) as a result of lowered tax rates, which would have the unintended effect of reducing the incentive for charitable giving.

Preservation of the nonitemizers' deduction is an urgent matter for voluntary organizations such as the YMCA and the millions of persons whose lives are touched and whose needs are met by this important sector. We urge the Committee's full and timely support for legislation (S 361) to make permanent the deduction for charitable contributions by nonitemizing taxpayers.

Sincerely,

Christopher Mould

Christopher M. Mould
General Counsel

cc: Members of the Committee on Finance

L. Stanton Williams
Chairman, National Board

Solon B. Cousins
National Executive Director